



EUI Working Papers

MWP 2010/31
MAX WEBER PROGRAMME

THE PRIVATIZATION OF MILITARY AND SECURITY SERVICES
AND THE LIMITS OF CONTRACT LAW

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ISSN 1830-7728

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Printed in Italy
European University Institute
Badia Fiesolana
I – 50014 San Domenico di Fiesole (FI)
Italy
Hwww.eui.eu
Hcadmus.eui.eu

Abstract

A growing body of literature has focused in recent years on the potentialities for market mechanisms to improve the enforcement of international human rights law against the breaches committed by private military and security companies (“PMSCs”) employed by sovereign entities. Yet, of all the avenues known by the law of contract to increase the degree of compliance with international law, none is ever included in the contracts between the States and PMSCs.

This paper gives an account of this reluctance on the part of the States, based on a survey of the contracts concluded by the U.S. administration during the first stage of the Iraq occupation and the comparative analysis of public and private organizations. In contrast to domestic outsourcing, the provision of military force takes place in conditions of high bilateral dependency, social embeddedness, specific contractual hazards, that taken together deter from traditional methods of contract enforcement (litigation and arbitration) and emphasize mechanisms based on reputational mechanisms and hierarchy .

These limitations should be attentively considered in shaping the role of contract standardization into a comprehensive regulatory strategy at national and international level.

Keywords

Private Military and Security Companies Regulation – Privatisation - Contract Law – Transactions costs

Introduction

On the 31 of December 2009, a federal judge in Washington dismissed the indictment of five former Blackwater security guards over a shooting in Baghdad that left seventeen Iraqis dead and twenty more injured, on the ground of the constitutional guarantee against self-incrimination.¹ The decision brought once again to the fore the government's inability to hold private contractors responsible for their crimes. Nor shall their employers, at least in the foreseeable future. Soon after the judgement, an outraged Iraqi government declared that it would file civil lawsuits in the U.S. and Iraq against Xe Services, as Blackwater has since renamed itself. However, the chances of success of these actions are impaired by the settlements accepted by the families of the victims.² Had the victims not settled, the military contractor defence doctrine would have stood as a formidable barrier against Blackwater's liability under state tort law,³ despite early signs from the Courts of a more critical approach to the immunity granted to contractors.⁴ On the other hand, a claim based on the Alien Tort Statute would not have done any better «because there is no consensus that *private* acts [...] violate the law of nations».⁵ Finally, were tort liability not barred by either settlements or immunities granted to government contractors, the Nisour Square massacre would all the same stand as an exception in the dockets, given the unique circumstances in which it took place: in broad daylight, in the centre of Baghdad, during a military occupation extensively covered by the media; most trials over contractors' wrongdoings face a much harder burden of proof - and proportionally higher costs - as they occur far from the public eye.⁶ It is no surprise that lawyers have been seeking out different answers than those offered by liability in tort.

In the aftermath of the second Iraq war, a growing body of literature has focused on the potentialities for market mechanisms to improve the enforcement of international human rights law against the breaches committed by private military and security companies (hereinafter "PMCSs") employed by sovereign entities. To illustrate this point let us suppose for a moment that the U.S. government had filed an action for the events of Nisour Square, based on its contract with Blackwater. Would such an action for breach of contract have more chances compared to criminal and tort lawsuits? Arguably not. To begin with, contract damages are supposed to compensate for the loss *actually* suffered by the plaintiff, whereas in this case the victims are typically third parties to the

¹ The investigators had actually agreed with the accused not to use their statements in a criminal case.

² A civil action filed against Blackwater and its founder, Erik Prince, under the federal Alien Tort Statute (ATS) for committing war crimes and summary execution (*Estate of Himoud Saed Abtan, et al. v. Prince, et al.*) was dismissed due to settlement on January 6, 2010.

³ The defense extends the sovereign immunity (also dubbed «political question») doctrine on the rationale that an expanded contractor liability would increase the costs of Government outsourcing: see *Boyle vs. United Technologies Corp.*, 487 U.S. 500 (1992). On Sept. 11 2009 a panel of the Court of Appeals for the District of Columbia affirmed the dismissal of all claims against Titan/L-3, and, reversing to the district court, also dismissed all claims against CACI Int. Inc. for the tortures committed by its contractors at Abu Ghraib. See: *Saleh et al v. Titan Corp.*

⁴ In *Lane v. Halliburton*, 529 F.3d 548 (5th Cir. 2008) and *McMahon v. Presidential Airways, Inc.*, 502 F.3d 1331 (11th Cir. 2007) two Courts of Appeal interpreted restrictively the political question doctrine in global war on terror cases (GWAC) filed against contractors on torts. See: ADDICOTT, *The Political Question Doctrine and Civil Liability for Contracting Companies on the "Battlefield"*, 28 *Rev. Litig.* 343 (2008); CARTER, *Halliburton Hears a Who? Political Question Doctrine in the Global War on Terror and Their Impact on Government Contingency Contracting*, 88 *Mil. L. Rev.*, 87 (2009).

⁵ *Ibrahim v. Titan Corp.*, 391 F. Supp. 2d 10 (D.D.C.) 2005 at 14-15. Quoted by *Saleh et al v. Titan Corp.*, at n. 3. Emphasis in the text. The Second Circuit, however, held that for certain categories of action (such as genocide) the ATS applies to any conduct «whether undertaken by those acting under the auspices of a state or only as private individuals»: *Kadic v. Karadzic*, 70 F.3d 232, 239 (2d Cir. 1995). See: SCHWARTZ, *Saleh v. Titan Corporation: The Alien Tort Claims Act: More Bark Than Bite? Procedural Limitations and the Future of ATCA Litigation Against Corporate Contractors*, 37 *Rutgers L.J.* 867 (2006).

⁶ O'BRIEN, *What Should and What Should not Be Regulated* in CHESTERMAN and LEHNARDT (eds.), *From Mercenaries to Market: The Rise and Regulation of Private Military Companies*, Oxford: Oxford University Press, 2007, p. 38

contract. Second, the contracts between the U.S. administration and PMSCs fail to connect whatever form of contractual liability to human rights law infringements, just as they generally fail to require private actors to comply with international law standards. Third and finally, these agreements do not provide for more sophisticated tools than remedies for breach, such as input requirements, minimum levels of investment in personnel training, monitoring mechanisms, and so on. In other words, among the several avenues known by the law of contract to increase the probability of compliance with international humanitarian law and human rights, not even one actually shows up in the agreements concluded by the U.S. government with the private providers of military and security services.

To be sure, nothing in the law logically prevents a government from having a term in the contract according to which the crimes committed by PMSCs' employees are sanctioned by the awards of damages. One can even speculate about the possibility of entitling the victims or some interested groups, or both, to sue. Considering the existent high degree of interdependence among public and private actors in accomplishing tasks once deemed intrinsically «sovereign» at domestic level,⁷ the advocates of an expanded role of contract law claim that the privatization of military and security services does not necessarily imply a withdrawal from the standards of accountability granted by international law against states and their representatives.⁸ The delegation of military functions to private actors, so runs the argument, can tap into contract law and self-regulation in order to expand the range of accountability mechanisms to which recourse can be made in order to enforce international legal standards.⁹ This solution, it is added sometimes, would even appeal to the upper layer of the industry, eager to drive «bad» companies out of the market.¹⁰

The rise of a market-based regulatory option begs a counter-factual question: if governance by contract would improve the accountability standards while strengthening the more responsible part of the industry, why do *actual* contracts fall dramatically short of these goals?

An obvious, «realist» explanation focuses on what the outsourcing of security services is ultimately about: the opportunity for governments to lessen the political and economic burden of warfare, military occupations, peacekeeping operations, and to perform tasks that would not otherwise be performed, due to political and legal constraints.¹¹ In other words, privatisation of military and security services hardly involves human rights protection. This rationale grasps two insights of paramount importance when it comes to contractual design: *first*, PMSCs establish bilateral dependency relations with their major sovereign principals, as the former depend on public procurement and, conversely, the latter rely on the former to promote their foreign policy agenda and perform military operations; *second*, human rights protection has a cost that contractual partners will not spontaneously internalise.

⁷ FREEMAN, *The Private Role in Public Governance*, 75 N.Y.U. L. REV., 543 (2000), EAD., *Extending Public Law Norms Through Privatization*, 116 *Harv. L. Rev.* 1285 et seq. (2003).

⁸ DICKINSON, *Government for Hire. Privatizing Foreign Affairs and the Problem of Accountability Under International Law*, 45 *Wil'm and Mary L. Rev.*, 135 (2005); EAD., *Public Law Values in a Privatized World*, 31 *The Yale Journal of International Law*, 383; EAD., *Contract as a Tool for Regulating private Military Companies*, in Chesterman-Lenhardt, at n. 6; OSWALD, *Accountability of Contractors on Peace Operations: Suggestions for Better Governance*, Background Paper, Seminar on Challenges of Peace Operations, Beijing, 3-5 November 2004, at 46 et seq., available at <http://www.challengesproject.net>; THÜRER AND MACLAREN, *Military Outsourcing as a Case Study in the Accountability and Responsibility of Power*, in Reinisch and Kriebaum (eds.) *The Law of International Relations. Liber Amicorum Hanspeter Neuhold*, Eleven Int. Publishing: The Netherlands, 2007, pp. 347-369; Walker and Whyte, *Contracting Out War? Private Military Companies, Law and Regulation in the United Kingdom*, 54 *Int'l and Comp. Law Quarterly*, (2005), pp. 651-689, at pp. 687 ff.; ORTIZ, *The New Public Management of Security: the Contracting and Managerial State and the Private Military Industry*, *Public Money and Management*, 2010, pp. 35-41.

⁹ DICKINSON, 2006, at n. 8, pp. 401 ff.

¹⁰ BEARPARK and SCHULZ, *The Future of the Market*, in CHESTERMAN-LEHNARDT, supra at n. 6, pp. 239 ff.

¹¹ For instance PMSCs have been used by western governments to promote their foreign-policy agenda, circumventing the limits imposed at national or international level, such as Congressional addresses or U.N. embargos: see BAUM – MCGRAHAN, *Outsourcing War: The Evolution of Private Military Industry After the Cold War*, 2009. ADAMS, *The New Mercenaries and the Privatization of Conflict*, *Parameters*, vol 29 (2) (1999) 110; AVANT, *Privatizing military training*, 5 *Foreign Policy in Focus*, Available at: <http://www.foreignpolicyinfocus.org>. See also: Foreign and Commonwealth Office, *Private Military Companies: Options for Regulations*, <http://files.fco.gov.uk/und/hc577.pdf>, at para 50.

Yet, the picture provided by the realist account is incomplete and too far-reaching. Were the privatization merely about efficiency (broadly understood), the contracts – especially those that extend over a long period of time – would be written with a view to making credible and less costly commitments. Contrary to this assumption, the gaps in the contractual process and its outputs are by no means confined to human rights protection. Indeed, the agreements between the U.S. administration and the PMSCs in the context of the Iraq military occupation hardly meet the expectations raised by their inherent complexities and long-term character, not to mention the standards in force when governmental functions are outsourced within the U.S. itself.¹² A closer analysis of these contractual practices suggests that there is more involved in the outsourcing of military and security functions than the quest for efficiency. This residual and hidden factor should be taken into account when considering the merits and feasibility of a regulatory strategy centered on contractual reform.¹³

A more comprehensive explanation of the limits of contract law as a regulatory instrument focuses on the transactional barriers in the markets for security and military services and the hazards they entail:¹⁴ fragmentation on the demand side (triggering multiple principal-agent problems),¹⁵ lack of competition on the supply side (expanding the potentiality for holdups),¹⁶ difficulties in defining and controlling the services delivered (again, leaving room for opportunistic behaviour),¹⁷ to mention but a few. For those who share this perspective, the PMSCs' «issue» is essentially a problem of finding a suitable blend of regulatory arrangements: a combination of different (public, private, mixed) modes of governance, at different (national and transnational) levels, that would streamline the market processes with an eye to accountability and legitimacy.

Again, this perspective highlights a critical issue, but it is not entirely convincing. Once markets and hierarchies are seen as historically interacting, rather than alternative, forms of organization, due to negotiation and enforcement costs,¹⁸ there is no ground to consider accountability and legitimacy as the exclusive attributes of a particular – namely: public - way of managing security and force.¹⁹ But the same holds true for efficiency, which is better conceived as a function of regulation *vis-à-vis*

¹² *Infra*, sect. 2.

¹³ *Infra*, sect. 3.

¹⁴ FREDLAND and KENDRY, *The Privatisation of Military Force: Economic Virtues, Vices and Government Responsibility*, 13 *Cambridge Review of International Affairs*, 1999, pp. 147-164; FREDLAND, *Outsourcing Military Force: A Transaction Cost Perspective on the Role of Military Companies*, 15 *Defense and Peace Economics*, pp. 205-219; BRAUER, *An Economic Perspective on Mercenaries, Military Companies and the Privatisation of Force*, 13 *Cambridge Review of International Affairs*, 1999, pp. 130-146; ID., *Private Military Companies: Markets, Ethics, Economics*, in ANDREW – CAPARINI – PEANE PETER-BAKER (eds.), *Private Military Companies: Ethics, Policies and Civil-Military Relations*, London: Routledge, 2009, pp. 102-115; BRAUER and VAN TUYLL, *Castles, Battles, and Bombs. How Economics Explains Military History*, Chicago: The University of Chicago Press, 2008, pp. 307-318.

¹⁵ COCKAYNE, *Make or buy? Principal-Agent Theory and the Regulation of Private Military Companies*, in CHESTERMAN-LENHARDT, at n. 6, pp. 196-215, at pp. 209 ff.; AVANT, *The Emerging Market for Private Military Services and the Problems of Regulation*, in CHESTERMAN-LENHARDT, at n. 6, pp. 181-195 (arguing for the development of process and organizations to articulate international professional standards).

¹⁶ FREDLAND-KENDRY, at n. 14, p. 159.

¹⁷ AVANT, 2007, COCKAYNE, 2007: both at note 15.

¹⁸ This insight was developed by Ronald Coase in two seminal essays: COASE, *The Nature of the Firm*, 4 *Economica* (1937), pp. 386-405; ID., *The Problem of Social Cost*, 3 *J.L. & ECON.* 1 (1960), and developed by Oliver Williamson in the most comprehensive comparative analysis of economic institutions: cf. WILLIAMSON, *Markets and Hierarchies: Analysis and Antitrust Implications*, New York: The Free Press, 1975; ID., *The Governance of Contractual Relations*, 22 *Journal of Law and Economics* (1979), pp. 233-261; ID., *Comparative Economic Organization: The Analysis of Discrete Structural Alternatives*, 36 *Administrative Science Quarterly* (1991) pp. 269; ID., *Public and private bureaucracies: A transaction cost economics perspective*, 15 *Journal of Law, Economics and Organization* (1999), pp. 306 ff.; ID., *The Economics of Governance*, 95 *American Economic Review Papers and Proceedings* (2005), pp. 1 ff.

¹⁹ BRAUER, *An Economic Perspective on Mercenaries, Military Companies, and the Privatization of Force*, *Cambridge Review of International Affairs*, 1999, 130-146.

certain constraints, rather than an exclusive province of market transactions.²⁰ That contract law can efficiently regulate PMSCs, while ensuring a high degree of accountability, in other words, is not something to take for granted.

The implications of this insight for the design of contracts between States and PMSCs have not yet been fully investigated by the scholars. This paper is meant as a step in this direction. Its central claim is that, contrary to what is commonly held, the dependence of PMSCs on governmental procurement might be a hindrance, and *not* a pre-condition, of a regulatory strategy focused on contract standardisation, depending on the structure of the transactions between the military provider and its customer. The analysis of the Iraq occupation suggests that the possibilities of success of a regulatory scheme based on contract law are inversely proportional to the integration of PMSCs into the military.²¹

This conclusion hardly aspires to general validity. There are not one, but several markets for force: the identity (public or private, national or transnational) of the customer; the structure, reputation, capability, home state of the provider; the characteristics of the service outsourced are but the most relevant dimensions that regulation should take into account. This paper considers a particular market, albeit a huge one: that formed by the contracts for typically «sovereign» tasks²² between the U.S. and its corporate providers based in either the U.S. or the United Kingdom during the first stage of the Iraq occupation, whose content has been declassified thanks to a Freedom of Information Act lawsuit promoted by a public interest group.²³ This choice was prompted by the consideration that the size of the market (the Department of Defence being by far the most significant customer of private military companies) and the extension and complexity of regulation (the apparatus governing the outsourcing process being unparalleled, just as unparalleled was its failure) are the touchstone of a (still hypothetical) initiative at the European or international level aimed at harmonizing the outsourcing of security and military services.

The argument develops along three sections. *Section 2* analyses the contractual design of the agreements between the U.S. government and PMSCs, showing how the expectations raised by their inherent complexities, long-term character, and relation to sovereign functions are disappointed by real contractual arrangements. *Section 3* explains this puzzling exception to governmental long term contracting as a function of the growing integration of the latter into the chain of command. *Section 4* concludes with some policy considerations concerning the regulation of the contracts between sovereign entities and PMSCs.

«A convoluted system of Management»: the Breakdown of the Defense Public Acquisition System in Iraq

Defense procurement contracts vary across several dimensions as for awarding procedures, methods of cost control, contractual formats, monitoring and enforcing mechanisms. The choice among these elements reflects cost-effectiveness and policy concerns and is contingent upon endogenous and exogenous factors. Under the former definition are those factors internal to, and depending upon, the sovereign entity: the regulations concerning awarding procedures; the administrative controls; the kind of performance (services, supply of goods, construction) contracted for and its characteristics (complexity, time extension, financial size), etc., are all endogenous factors that matters for contractual design. Conversely, exogenous factors are not contingent on the outsourcing state, such as

²⁰ WILLIAMSON (1999), at. n. 18, pp. 330 ff.; HART, SHLEIFER, VISHNY, *The proper scope of government: theory and an application to prisons*, 112 *Quarterly Journal of Economics*, (1997), pp. 1126-61.

²¹ *Infra*, sect. 3

²² Defined as those tasks for which «public authority is deemed necessary [...] loyalty to the State is fundamental and which may pose implications for the security of the state»: see WILLIAMSON, 1999, at 322. For an inquiry of different national approaches to the privatization of security in western countries see now: KRAHMANN, *States, Citizens and the Privatisation of Security*, Cambridge: Cambridge University Press, 2010.

²³ See: <http://projects.publicintegrity.org/wow/>; <http://projects.publicintegrity.org/wowII/>. Also the Federal procurement database provides for a lot of useful data (www.fpd.gov).

the capability, organization, reputation of the contractor and, most importantly in our case, the «endemic uncertainty of virtually any military situation».²⁴

This section analyses some critical facets of the procurement of supplies and services in the Iraq reconstruction - acquisition procedures, contract formats, monitoring processes – focusing on the way in which contractual design is influenced by esogenous and endogenous factors. The shortcomings of the market for force, it is suggested, are not different from those of the general market of Iraq reconstruction, but for their ambiguous relationship with the exercise of sovereign functions in a war environment (of which the silence when it comes to the allocation of the risk of human rights violations is a symptom, not a cause). Indeed, a failure to comply with the outsourcing process or to oversight the contract enforcement has quite different implications in a contract for building a hospital compared to a contract to perform security interrogations.

Waivers to competitive bidding are a major reason of concern in the literature concerning PMSCs, since the absence of competition is deemed to feed the PMCs' sense of impunity and favour the kind of murky environment prone to human rights abuses.²⁵ The Federal Acquisition Regulation (FAR) and its Department of Defense implementation (DFARS) mandate full and open competition as the normal procedure in public procurement.²⁶ That this is often waived should not come as surprise in the context of a military occupation. The federal system acknowledges this eventuality and allows some degree of flexibility in ordinary as well as emergency and contingent acquisition procedures.²⁷ Several military and security services actually fall under the FAR provisions concerning acquisition in contingency operations,²⁸ where an «element of immediate risk to human life or significant national interests» is involved.²⁹ However, simplified, emergency and contingent acquisition procedures should only apply when urgent requirements are met, provided that market research analysis is conducted and documented, and all needed measures to avoid conflicts of interests are adopted.³⁰ These cautions have been all too often circumvented in Iraq and Afghanistan. The peculiarities of the industry - the market being dominated by relatively few, deeply embedded, large enterprises, with strong personal links to

²⁴ FREDLAND-KENDRY, *supra*, n. 14, at p. 162.

²⁵ DICKINSON (2005, 2006, 2007) at n. 8; SCHOONER, *Competitive Sourcing Policy: More Sail than Rudder?* 33 *Public Contract Law Journal* 263 (2004); *ID.*, *Contractors Atrocities at Abu Ghraib: Compromised Accountability in a Streamlined, Outsourced Government*, 16 *Stan. Law & Pol'y Rev.*, 549 (2005); SCHOONER AND GREENSPAHN, *Too dependent on Contractors? Minimum Standards for Responsible Governance*, *Journal Of Contract Management*, 2008, pp. 8; MINOW, *Outsourcing Power: how Privatising Military Efforts Challenges Accountability, Professionalism and Democracy*, 46 *B. C. L. Rev.*, 989 (2004-2005).

²⁶ Cf. 48 C.F.R., part. 6.

²⁷ Cf. 48 C.F.R., part. 18.

²⁸ Cf. 48 C.F.R., part. 2.101: «“Contingency operation” ([10 U.S.C. 101\(a\)\(13\)](#)) means a military operation that (1) Is designated by the Secretary of Defense as an operation in which members of the armed forces are or may become involved in military actions, operations, or hostilities against an enemy of the United States or against an opposing military force; or (2) Results in the call or order to, or retention on, active duty of members of the uniformed services under section [688](#), [12301\(a\)](#), [12302](#), [12304](#), [12305](#), or [12406](#) of [10 U.S.C.](#), [Chapter 15 of 10 U.S.C.](#), or any other provision of law during a war or during a national emergency declared by the President or Congress».

²⁹ This is precisely what distinguishes contingency from ordinary contracting procedures according to the Defense Acquisition University. There is no authoritative definition of «contingency contracting». For academical purposes it is defined as «[d]irect contracting support to tactical and operational forces engaged in the full spectrum of armed conflict and Military Operations Other Than War, both domestic and overseas» The definition is «purposely exclusive of: military training exercises, routine installation and base operations, and systems/inventory control point contracting». See also: YODER, *The Yoder Three-Tiered Model for Optimal Contingency Planning and Execution of Contingency Contracting*, Naval Post-Graduate School, Contracting for Deployed Forces Panel, May 19, 2005 (online at: http://www.nps.navy.mil/gsbpp/ACQN/publications/FY05/AM-05-004_Proceedings_ThursdayPM.pdf).

³⁰ The testimony before the U.S. Senate of the Special Inspector General for the Iraq Reconstruction (SIGIR), recommends to «generally avoid using sole-source and limited competition contracting actions. These exceptional contracting actions can be used in exceptional cases, but the emphasis must always be on full transparency in contracting and procurement. The use of sole-source and limited competition contracting in Iraq should have diminished as the program matured and previously sole-sourced limited competition contracts should have been promptly re-bid» (*Improving Contracting and Government Oversight of Contractors Performing Work in Contingency Operations*, 08-001T, at 5).

the Government and extensive capacity for lobbying – leave little room for careful scrutiny and point instead at collusion and regulatory capture.

Although it is not far-fetched to assume that the lack of competition accrues to a hospitable environment for human rights abuses, the laxing of competitive tendering procedures *per se* would hardly explain the failures of the system. Its overriding justification - urgency combined with the difficulty to specify the task in advance – is perfectly sound in a contingency environment, due to the difficulty of describing contingent events and price them out accordingly. Rather, it is important to focus on the overall design: the combination of waivers to bidding procedures, leverage on open-ended contract schemes, poor contract monitoring, framed into a «a convoluted system of management»,³¹ that ultimately hatched Nisour Square, Abu Ghraib and a myriad of less notorious crimes and abuses.

Since 1985 defense contracts are awarded in the framework of the army-administered Logistics Civil Augmentation Program (“LOGCAP”), whose 2001 iteration (LOGCAP III) was awarded on a no-bid basis to Kellogg, Brown & Root Services, Inc. (KBR), a subsidiary of Halliburton, Inc. LOGCAP III was itself an «open-ended» or «indefinite delivery/indefinite quantity» (ID/IQ, also dubbed «umbrella») procurement defense contract, which allowed the military to issue single task orders to support military contingency operations in Iraq and Afghanistan. These task order, or ID/IQ, contracts are typically used to procure supplies and/or services when the exact times and/or exact quantities of future deliveries are not known at the time of contract award. They are awarded on either a cost-reimbursement or a fixed-price basis, the former scheme being predictably the most popular one, as the uncertainties of contracts performance require flexibility in pricing.³²

The prevalence of cost-plus over fixed-price contracts marks a preference for ex-post adaptation over high-powered incentives.³³ The advantages for both sides of the deal are apparent: ID/IQ cost reimbursement contracts allow great flexibility in quantities and delivery scheduling; strengthen the ability for the public agency to order supplies and services only after specific requirements for them materialize; streamline the procurement process. The cost and performance risk is placed on the Government in exchange of (relatively) moderate profits. Also they allow risk averse firms to manage the heavy financial risks associated with large size projects and contingency conditions. The impossibility to provide sufficient information in order to accurately determine a competitive price is indeed the typical argument for the adoption of cost-reimbursement contracts³⁴ and a mandatory condition under the Federal Acquisition Regulations.³⁵ On the other hand, the most serious criticism against cost-reimbursement contracts is the lack of incentives to exercise cost controls. Even worst, costs might inflate if, as it typically happens, fees are calculated as a percentage thereof.³⁶

As for competitive tendering, the criticisms raised against open-ended contracts awarded to PMSCs on a cost-reimbursement basis actually miss the overall point. A context of contractual incompleteness and uncertainty at the highest level might well justify the choice of a cost-reimbursement long-term

³¹ *Ibidem*, at 3.

³² Under fixed-price task orders payment is made to the contractor on the basis of pre-established prices; under cost-reimbursement task orders, the U.S. government reimburses the contractor for all allowable, allocable, and reasonable contract costs.

³³ Cf. BAJARI & TADELIS, *Incentives versus Transaction Costs: A Theory of Procurement Contracts*, 32 *Rand Journal of Economics*, pp. 387-407.

³⁴ *Id.* § 16.301-2.

³⁵ Cf. NASH, *et. al.*, *The Government Contracts Reference Book*, 1998².

³⁶ The LOGCAP III program was eventually ended by the Army after the Defense Contract Audit Agency identified \$ 2.1 billion in «questioned costs» and \$ 1.4 billion in «unsupported costs» charged by Halliburton through KBR (about 1% of the DoD total contract activity for reconstruction and stabilization efforts between 2003-2006) See U.S. Government Accountability Office, *Iraq Contract Cost: DoD Consideration of Defense Contracting Audit Agency's Findings*. GAO-06-1132 (2006). «Questioned» are defined the costs unacceptable for negotiating reasonable contract prices; «unsupported» are the costs that lack of sufficient documentation. The new LOGCAP (IV) has been awarded on a competitive basis to three companies (included KBR) that compete for tasks orders. A fourth company is in charge for administrative planning.

contract scheme. From the point of view of promoting human rights protection this solution might even turn out to be superior to its fixed-price alternative, that might lead firms to curtail the investments in security. However, cost-reimbursement schemes must rely on a powerful system of monitoring since they are a hospitable environment to agency problems. Long-term contracts in particular require the principal to strictly monitor its agent's performance, since situations of non-performance are difficult to verify *ex post*, all the more in a wartime environment. Moreover, in the context of public procurement the levels of control are doubled, since the obligation to preserve political responsibility for the outcomes greatly accrues to the quest for controls also *internal* to the public administration.

To address the first problem (agency relationship) federal procurement statutes and regulations rely upon «contracting officers». A contracting officer is «a person with the authority to enter into, administer, and/or terminate contracts»,³⁷ who is also «responsible for ensuring performance of all necessary actions for effective contracting, ensuring compliance with the terms of the contracts and safeguarding the interests of the U.S. in its contractual relationships».³⁸ In the years of the race to privatisation the acquisition workforce was dramatically reduced.³⁹ Again, this is hardly a peculiarity of defense public procurement, although in this case a shrunk acquisition force had to face a post-9/11 expansion of federal procurement unheard of in other sectors.

The second problem (internal political accountability) is addressed by federal legislation by severing programmatic authority from procurement authority: agencies must rely upon contracting officers to keep procurement within the limits of established political and financial constraints.⁴⁰ Unfortunately, the system is undermined by interagency procurement, a practice originally meant to allow the agencies to take advantage of mutual expertise that over time has evolved into a system to circumvent legislative restrictions to the employment of funds. As the end of the fiscal year approaches, agencies «park» their funds issuing open-ended orders that do not answer to effective needs nor state specific requirements.⁴¹ To save time and administrative effort, other agencies place their orders against the open-ended contracts awarded by another agency. It certainly does not help that interagency procurement works like a business, on a fee-for-service basis, turning the public service mission upside-down, as the emphasis is placed more on customer satisfaction and revenues generation than on compliance with contracting policy and procedures. A report from the Department of the Interior pointed at «the inherent conflict in a fee-for-service operation, where procurement personnel in the eagerness to enhance organization revenues have found shortcuts to Federal procurement procedures and procured services for clients whose own agencies might not do so».⁴²

The result was a breakdown of the contract administration system, which eventually involved major human rights violations.⁴³ This point is illustrated by the contract between the Department of Defense («DoD») and CACI Intern. Inc., whose contractors, together with military personnel, were accused of abuses against the prisoners at Abu Ghraib. The acquisition procedure in this case is a compendium of all the missteps that have been seen so far. To procure interrogation services quickly, the DoD relied on an Interior contracting office that awards and administers contracts for other agencies on a fee-for-service basis. This latter placed the task orders against a blank purchase agreement for information technology services that CACI had in place with the General Services Administration (GSA) since 2000. In 2003, over an 8-month period, the Interior contracting office issued 11 task orders, valued at over \$ 66 million, to CACI on behalf of the DoD. Of the 11 orders, 6

³⁷ 48 CFR § 2.101

³⁸ *Id.* § 1.602-2

³⁹ SCHOONER AND GREENSPAHN, *supra* n. 25, at pp. 14-16.

⁴⁰ 48 CFR § 1.6.

⁴¹ SCHOONER (2005), *supra* n. 25, at p. 18.

⁴² Memorandum from Earl Devaney, Inspector Gen., Dep't of Interior, to Assistant Sec'y for Pol'y, Mgmt. & Budget (July 16, 2004) <http://www.oig.doi.gov/upload/CACI%20LETTER3.pdf>, at p. 3.

⁴³ See U.S. Government Accountability Office, *Interagency Contracting: Problems with DoD's and Interiors's Orders to Support Military Operations*, GAO-25-201, p. 7 ff.

were for interrogation, screening, and other intelligence-related services, 5 for logistics support services. Each task order fills a three-pages standard form with administrative information (data concerning the contractor, identity of the contracting officer, billing instructions) and the amount of price. As for the crucial statement of work – «the portion of a contract that describes the actual work to be done» and « serves as a baseline against which progress and subsequent contractual changes are measured during contract performance»⁴⁴ - it laconically reads: «the contractor will provide interrogation support cells [...] to assist, supervise, coordinate, and monitor all aspects of interrogation activities, in order to provide timely and actionable intelligence to the commander». The *statements* did not require any specific training either for the use of force, notwithstanding a 2005 DoD instruction,⁴⁵ or for interrogation techniques and policies;⁴⁶ did not provide for performance standards or monitoring methods; needless to say, did not mandate compliance with human rights or international humanitarian law concerning the treatment of prisoners, such as the Torture Convention or the Geneva Conventions.

The Interior Inspector General and the General Services Administration (“GSA”) subsequently found that 10 of the 11 orders were out of the scope of the information technology contract. Following the disclosure of the prisoner abuse at Abu Ghraib and the implication of contractor employees in the abuse, questions arose about how DoD used Interior to acquire interrogators and screeners on an information technology contract and, more generally, about the integrity of the federal procurement process.

To sum up, the contracts between the DoD and CACI Inc. eventually resulted in: orders for services beyond the scope of the underlying contract, in violation of competition rules; abuses in the interagency contracting procedure; not complying with ordering procedures meant to ensure best value for the government; inadequate monitoring of contractor performance.

The flaws in the public procurement system mirror in the most hideous violations of human rights perpetrated by contractors. Yet, the breakdown of the acquisition system is not the ultimate responsible of the abuses. Although proper contract management and supervision might have significantly reduced the room for violations, public procurement regulations are focused on the cost-effective performance of federal policies and programs, from which human rights concerns are totally removed. From the hiring state’s perspective human rights legislation is a cost, not a normative standard to review contractors’ compliance. The same holds for liability in tort. As the Columbia District Federal Appeal Court unabashedly makes clear, dismissing an action brought against the companies involved in the interrogations at Abu Ghraib, «the costs of imposing tort liability on government contractors [would be] passed through to the American taxpayer».⁴⁷

The Nature of the Military Firm

The insulation of public procurement regulation from human rights concerns takes on a particular meaning whenever the acquisition involves «uniquely federal interests».⁴⁸ These contracts are government contracts. If we could set aside for a moment their intimate relation to sovereignty and contingency environments, they would not seem to be any different from the contracts outsourcing other governmental functions. Accordingly, we would expect them to look like «ordinary» public procurement contracts. In other words, we would expect to find an extensive use of standard terms to regulate this critical market: clauses granting the public party flexibility in the definition of the tasks to

⁴⁴ NASH ET AL., *supra* n. 33, at p. 492.

⁴⁵ Department of Defense Instruction, No. 3020.41, § 6.1 (Oct. 3, 2005).

⁴⁶ As a result 35% of CACI contractors were found without «formal training in military interrogation policies and techniques». Cf. DEP’T OF THE ARMY, INSPECTOR GEN., DETAINEE OPERATIONS INSPECTION 87-89(2004): <http://www4.army.mil/ocpa/reports/ArmyIGDetaineeAbuse/DAIG%20Detainee%20Operations%20Inspection%20Report.pdf>.

⁴⁷ Court of Appeals of the District of Columbia, *Saleh et al v. Titan Corp supra*, n. 3.

⁴⁸ *Boyle v. United Technologies Corp.*, 487 U.S. 500 (1988).

be performed and discretion in monitoring and directing the contractors' performance; a power of unilateral variation supplemented *either* by a price variation mechanism, to induce cooperation, *or* by a bilateral governance mechanism in charge for resolving disputes about price, when the contract is of the time & materials type (fixed price); quality standards (defined in input or output terms). Finally, considering the dire impact of PMSCs activities on civil populations, we would expect clauses requiring compliance with fundamental rights assessed at national and international level;⁴⁹ adopting performance standards concerning security, training and self-monitoring; imposing third-party insurance, like those provided in domestic contracts for the management of prisons.⁵⁰

These expectations must be disappointed. As shown by the previous section, the «privatisation» of military sovereign services in Iraq do not even remotely approximate the «ordinary» public procurement template. In what follows this puzzling exception is explained as a function of the growing integration of the PMSCs into the chain of command. To illustrate this point I will (i) use a transaction cost framework to analyze the relation between the Army and PMSCs; (ii) compare this relation with a different kind of transactional arrangement between a sovereign entity and a PMSC: the (in)famous case of the contract between the Sandline Executive and the New Papua Government.

Through the post-Cold War period until the second Iraq war, the public opinion in western countries had been growing accustomed to consider the outsourcing of national security tasks as an ordinary public procurement issue,⁵¹ driven by the broader trend to privatization, the downsizing of national armed forces, the proliferation of intrastate conflicts that NATO countries were neither prepared nor willing to fight - but could not ignore either. In that context PMSCs provided for an alternative to military intervention in trouble spots, where primary national interests were not immediately at stake; flanked national armies in logistic support and peacekeeping operations; occasionally acted as their more or less concealed proxies, enabling Governments to bypass national legislation or U.N. embargos against the deployment of troops.⁵² This division of labour did not challenge the mainstream economics conventional view, according to which everything is fine with military outsourcing as far as it allows defense budget cuts and do not encroach upon national armies' «essential core of activity».⁵³

This scenario has changed abruptly after Sept. 11 attacks. According to the Congressional Budget Office «since September 2001, the Congress has appropriated \$ 602 billion for military operations and other activities related to Iraq, Afghanistan, and the war on terrorism».⁵⁴ The DoD performed the lion's share in the largest increase in the hidden workforce of contractors since the end of the Cold War: «between 2002 and 2005, the number of Defense contract employees jumped from 3.4 million to 5.2 million, with a mix of jobs in both “hard contracts” for material and “soft contracts” for

⁴⁹ For a systematic review of the general international legislation concerning human rights affected by PMSCs see: FRANCONI and LENZERINI, *The Role of Human Rights in the Regulation of Private Military and Security Companies, General Report – Universal and Regional System: Latin-America, Africa and Asia*, EUI WP, AEL 2009/16, available at: www.eui.eu.

⁵⁰ Under Federal Acquisition Regulations, part. 52-228.7, *Insurance. Liability to Third Persons*, third party liability insurance is available limited to cost-reimbursement type contracts and «subject to the availability of appropriated funds at the time a contingency occurs».

⁵¹ HARTLEY, *The Economics of Military Outsourcing*, DEFENCE STUDIES, vol. 4, n. 2 (2004), 199-206, at 203.

⁵² See MILLIARD, *Overcoming Post-Colonial Myopia: A Call to Recognize and Regulate Private Military Companies*, 176 MIL. L. REV. 1 (2003); AVANT, *Think Again: Mercenaries*, FOREIGN POLICY, July/August 2004

⁵³ HARTLEY, at n. 16. Unfortunately, because this is not a statement of fact, but a normative judgement, the very notion of what it is an army's «essential core of activity» - like its companion: «inherently governmental act» - varies over time. This is not to say, however, that *anything goes* with the outsourcing of military services, as long as it is economically convenient. Quite to the contrary, this is an issue of paramount constitutional importance that cannot be resolved on the basis of purely economic criteria. See also 48 C.F.R. 7.503, listing as «inherently governmental», among other things, the command of military forces, the conduct of foreign relations and the determination of foreign policy, and the direction and control of intelligence and counter-intelligence operations.

⁵⁴ Congressional Budget Office, *Estimated Costs of U.S. Operations in Iraq and Afghanistan and of Other Activities Related to the War on Terrorism: Hearing Before the H. Comm. on the Budget*, 110th Cong. (2007), available at http://www.cbo.gov/ftpdocs/84xx/doc8497/07-30-WarCosts_Testimony.pdf

services».⁵⁵ The ratio of U.S. military troops to security contractors escalated from 50:1 to 10:1 from the first to the second Iraq war.⁵⁶ By the end of 2008 more than 190.000 private contractors worked in Iraq. Those directly involved in military and security tasks are calculated in about 40.000.⁵⁷

The more the U.S. Army relies upon private contractors, the more the «essential core of activity» frontier is pushed outward. In the age of the «war on terror» – according to an official document of the Army - it includes «offense, defense, stability, and support within *all types of military actions from small-scale contingencies to major theater of wars*» (emphasis added).⁵⁸ The scope and quality of this reliance generate a bilateral expectation of continuity. Particularly when high technology or intelligence services are involved, such as providing and operating sophisticated weapons systems, continuity becomes of essence for both partners, since the resources employed by the private sector cannot be redeployed to alternative uses without substantive losses of productive value⁵⁹ and, conversely, the defence looks strategically at the private sector, as an integral part of the military force. As a consequence, highly specific and continuous transactions prevail upon (equally specific, but) occasional transactions.

As if moving in parallel, the governance architecture is also shifting from relational, long-term contracting towards a kind of quasi-integrated organization, along the wide spectrum of «hybrid» structures, combining market and hierarchy attributes⁶⁰. The governance of the relation between the Department of Defense and its private sector military providers in Iraq is indeed a blend of high-powered incentives, typical of market transactions, with administrative controls and enforcement strategies veering towards vertical integration.

Once again, the infelicitous Appeal judgement in *Saleh vs Titan* provides a unique testimony of the issues at stake. The firms had filed for summary judgment, contending that the claims in torts against them should be preempted as claims against civilian contractors providing services to the military in a combat context.⁶¹ The district judge forged a test according to which the preemption defence stands only where contract employees are «under the direct command and exclusive operational control of the military chain of command».⁶² The Appeal Court endorsed this strategy: «We think that the district judge properly focused on the *chain of command and the degree of integration* that, in fact, existed between the military and both contractors' employees *rather than the contract terms*»; and further: «there is no dispute that [the contract employees] were in fact integrated and performing a common

⁵⁵ LIGHT, *The New True Size of the Government*, «Twenty years after the Reagan administration's defense build-up, the true size of government had come full circle. By 2005, the post-cold war peace dividend was completely gone. Like 1984, most of the contract-generated jobs were at Defense, where the war on terrorism had replaced the cold war. But unlike 1984, there is no sign that the growth trends will abate anytime soon. Although expenditures for the war in Iraq will eventually decline, the war on terrorism will continue to exert pressure for growth far into the future.

⁵⁶ AVANT, *The Privatization of Security and Change in the Control of Force*, INTERNATIONAL STUDIES PERSPECTIVES (2004) 5, 153-157. But see: ISENBERG, *A government in search of cover: the escalation in the military and security outsourcing was planned independently of Iraq's invasion*.

⁵⁷ Elsea et al. 2009

⁵⁸ See Department of the Army, Field Manual 3-100.21, *Contractors on the Battlefield* (Washington: Headquarters Department of the Army, January 2003), http://www.afsc.army.mil/gc/files/fm3_100x21.pdf, 1-1: «When considering contractor support - reads the Army manual dedicated to *Contractors on the battlefield* - it should be understood that it is more than just logistics; it spans the spectrum of combat support (CS) and combat service support (CSS) functions. Contracted support often includes traditional goods and services support, but may include interpreter, communications, infrastructure, and other non-logistic-related support. It also has applicability to the full range of Army operations, to include offense, defense, stability, and support within all types of military actions from small-scale contingencies to major theater of wars».

⁵⁹ McDONOUGH, *The Industrial Structure of National Defence and Transaction Costs*, DEFENCE AND PEACE ECONOMICS 16 (2005) pp. 245 –262; FREDLAND, 2004, supra at n. 14.

⁶⁰ See WILLIAMSON, 1999; 2005, supra at n. 18; MENARD, *The Economics of Hybrid Organisation*, *Journal of Institutional and Theoretical Economics*, 2004, pp. 345-376.

⁶¹ On the government contractors' defense: supra n. 3 and accompanying text.

⁶² *Ibrahim v. Titan Corp.*, 556 F. Supp. 2d 1, 5 (D.D.C. 2007).

mission with the military under ultimate military command». ⁶³ Had the Appeal Court applied this test to the Alien Tort Act claim, it could have not contend, as it did, that the conduct of contractors is irrelevant under international law. ⁶⁴

The reverse relationship between a hierarchical, ongoing transaction and the force of contract terms purported by both relational contract and transaction cost economics scholarships could have not been more clearly assessed: *the stronger the relation between the parties, the weaker the contract*. ⁶⁵ This also explains the otherwise puzzling incompleteness of these long term contractual relationships. Suppose an unanticipated event requires a PMSC an effort that differ in kind or quality from that provided by the contractual statement of work. Plainly, it would be idle to insist on contract terms. Rather, the parties shall have to work out themselves the solution and appeal to the hierarchy principle if accommodation is not found.

What is known of the enforcement regime of PMSCs contracts with the U.S. Government fits this conclusion. These contracts are not meant for litigation, either before a state court or an arbitral panel. While criminal and tort actions against PMSCs and/or their employees are occasionally filed by the Government, ⁶⁶ there are no actions for breach of contract, in spite of an ever-growing list of contractual breaches. When the DoD prematurely terminated the contract with KBR, upon allegations of «questioned» and «unsupported» costs, ⁶⁷ neither the company nor the government took action before a Court (eventually KBR's self-restraint has been rewarded, since it is one of the winner of LOGCAP IV). Not even after the termination of the contracts with CACI Int. Inc. after the facts at Abu Ghraib the administration filed an action based on the contracts. In absence of judicial or arbitral enforcement, the contract law of this particular hybrid organization results from a blend of termination, reputational sanctions and forbearance, «the implicit contract law of internal organization»: ⁶⁸ internal disputes will be resolved by fiat, rather than submitted to external review. Indeed, to open the relation between the military and PMSCs to judicial review would undermine military hierarchy.

Before considering the regulatory implications of dealing with a highly integrated hybrid structure, I would pause for a moment to consider its characteristics, as it were *e contrario*, by comparison with the Sandline vs New Papua Government case. ⁶⁹ In 1997 the Government of Papua-New Guinea hired a major military company, Sandline Int., ⁷⁰ to get rid of the Bougainville Revolutionary Army ("BRA"), an internal guerrilla force. The length of the contract was established in three months or achievement of the primary objective of «rendering the BRA militarily ineffective». This latter was delimited as follows: «The achievement of the primary objective cannot be deemed to be a performance measure for the sake of this agreement if it can be demonstrated that for valid reasons it cannot be achieved within the timescale and with the level of contracted resources provided». When the news spread over that the Government had hired Sandline there was an uprising in the army supported by the population, leading the Government to premature termination. Papua-New Guinea was eventually

⁶³ *Supra*, n. 3, at 7.

⁶⁴ *Supra*, n. 3, at 5.

⁶⁵ See MACNEIL, *The Many Futures of Contracts*, 47 *South. Cal. L. Rev.* 691 (1974); *Id.* *The New Social Contract*, 1979 Rosenthal Lectures, New Haven and London, 1980; *Id.*, *Contracts: Adjustment of Long-Term Economic Relations under Neoclassical, and Relational Contract Law*, 72 *Nw. U. L. Rev.* 854 (1978), at p. 901, describing how the progressively increasing in «duration and complexity» of contract has results in enforcement processes of a thoroughly transaction-specific, ongoing administrative kind.

⁶⁶ Custer Battles was ordered to pay \$10 million in damages and fines for civil fraud for services in Iraq

⁶⁷ *Supra*, Sect. 3, n. 36 and accompanying text.

⁶⁸ See WILLIAMSON, 1991; 2005, *supra* at n. 25.

⁶⁹ FREDLAND 2004; MCCORMACK, *The Sandline Affair: Papua New Guinea Resorts to Mercenarism to End the Bougainville Conflict*, 1 *Yearbook of International Humanitarian Law*, pp. 292-300 (1998); *Id.*, *Australian Report on National Legislation and Judicial Practice*, PRIV-WAR REPORT, 2009, available at <http://www.priv-war.eu>.

⁷⁰ The company was later dismantled only to reappear under the new corporate clothes of Aegis Defense services Ltd, actually in charge of the coordination of the movement of all DOD, Department of State, and other participating PSCs throughout Iraq.

condemned for breach of contract by an arbitral panel; on appeal the Supreme Court on Queensland declined its competence, after which the government negotiated a settlement for U.S. \$ 18.000.000.

The clause nicely epitomized a critical attribute of the transaction: contractual incompleteness, due to lack of information combined with asset specificity (human capital, weaponry etc.). More importantly, it also reflected the way *this* particular contract was incomplete. Due to the difficulty to verify the «valid reasons» preventing the contractor from achieving the «primary objective», and the vagueness in which both reasons and objective were expressed, this contract term was clearly a second-best solution compared to the use of a proxy for the required behaviour, such as a stricter definition of the minimum objectives, indication of minimum inputs, etc. This points in turn at the hazard the contract did not manage: the condition of bilateral dependency, which in the case of a weak state contracting with a major transnational military corporation was obviously asymmetric.

Still, there is more to the picture than «ordinary» bilateral dependency when contracts are terminated by the government under the pressure of a popular upheaval. Situations of uncertainty, requiring adaptive, sequential decision-making are difficult since they impose a continuous effort of cooperation upon the parties. When one of the partners is a State, and the transaction is «endowed with infeasible authority»,⁷¹ they may become prohibitive. This is by no means only a problem of weak or failed states. A 2007 report of the U.S. Government Accountability Office lucidly acknowledges in very broad terms the relation existing between the degree of involvement of private actors in the discharge of «inherently governmental functions» and the level of risk: «The closer contractor services come to supporting inherently governmental functions, the greater the risk of their influencing the government's control over and accountability for decisions that may be based, in part, on contractor work. This may result in decisions that are not in the best interest of the government, and may increase vulnerability to waste, fraud, or abuse».⁷²

In a seminal article on the comparative performances of public and private bureaucracies in managing sovereign transactions, Oliver Williamson labelled this particular category of risks «probit hazards», defined as multidimensional «loyalty and rectitude» in the discharge of transactions that rest upon the use of delicate information and require a continuous effort of coordinated adaptation to unanticipated disturbances.⁷³ The first attribute (access to strategic information) points at the potentially calamitous consequences of contractual incompleteness. No government can afford the risk of contractual holdups and permanent renegotiation,⁷⁴ not to mention of leakages, whose social costs could not be made up for by any remedy whatsoever among those offered by «traditional» contract law. The second attribute (permanent need for coordination) highlights the overarching issue raised by the privatisation of sovereign functions, i.e., the problem of determining «which mode of governance is best suited to effect adaptation and restore efficiency» and deserves thorough consideration.⁷⁵

Compared to the Sandline-New Papua affair, the governance structure of the transactions between the U.S. superpower and its private military providers stands at the opposite pole of the hybrids spectrum: a cost-reimbursement long term contract in the context of a quasi-integrated organization, as opposed to an occasional relationship framed by a fixed-price contract enforceable by arbitration. As for the capacity to relieve the hazards of probity, the former overtly outperforms the latter: the integration of a PMSC into the chain of command, and the downgrading of the contractual relationship it entails, are precisely the attempt to manage the continuous adaptation effort required by performance in a contingency environment without putting the mission at risk.

However, a quasi-integrated organization might still turn out to be inferior to straightforward in-house provision, in consideration of the high costs of the governance apparatus needed to protect strategic governmental interests from the conflict of interests latent in the privatisation of sovereign

⁷¹ WILSON, *Burocracy*, New York, 1989, quoted by WILLIAMSON, 1999, *supra* at n. 18, at p. 321.

⁷² GAO, *Improved Assessment and Oversight Needed to Manage Risk of Contracting for Selected Services*, Sept. 2007, available at: <http://www.gao.gov>, at p. 6.

⁷³ WILLIAMSON, *supra* at n. 18, p. 322. See also: FREDLAND, 2004; BAUM-MCGAHAN, 2009, *supra* at n. 18.

⁷⁴ This perspective is underlined by the contractual incompleteness literature: see HART et al., *supra*, at n. 20.

⁷⁵ WILLIAMSON, 1999, *supra* at n. 18, p. 333.

functions.⁷⁶ From this point of view, the whole Iraq reconstruction and stabilization effort may be seen as a huge experiment aimed at emending, by trial and error, the shortcomings of a public procurement system operating in long-term contingency conditions.⁷⁷

Most importantly, not all the issues raised by the commodification of military services may be resolved through contract monitoring. Even if the costs of setting up and implementing an efficient system of contract management were outweighed by the net gains resulting from outsourcing, which is by no means obvious,⁷⁸ some costs are simply outside of the reach of public procurement administration and cost-effectiveness calculus. The probity hazard consisting in failing to comply with human rights and international humanitarian law is one of those.

Human rights violations by contractors are seldom regarded as a matter of constitutional concern, in spite of the fact that constitutional and international law obligations «to prevent and remedy human rights violation within the jurisdictional sphere of the state» concur to define the legitimate limits of the exercise of sovereign power as a «matter of governmental functions».⁷⁹ This difficulty mirrors in the ambiguous relationship between the U.S. government and its private contractors, illustrated by a passage in the Appeal decision in *Saleh vs Titan*, according to which PMSCs are depicted as at once private entities and subjects «performing a common mission with the military under ultimate military command», in order to grant them the immunity.⁸⁰ By refusing to review the violations of human rights committed by private contractors, the judiciary allowed the administration to skirt the legal and political controls on the use of military force at national⁸¹ and international level.⁸²

The conclusion should not be any different once we look at PMSCs employees as the victims, rather than the perpetrators, of human rights abuses. Here, again, the discontinuity is bewildering between a well-intentioned, if perfectible, statutory scheme and its contractual implementation on the private side of the regulatory coin.

Under the *Defense Base Act* (“DBA”: 42 U.S.C. § 1651 et. seq.) in combination with the *War Hazards Compensation Act* (“WHCA”: 42 U.S.C. § 1701 et. seq.) and the *Federal Acquisition Act* (FAR, §§ 28.305, 52.228-3 or 52.223-4) mandatory insurance coverage is required for contractor employees performing under government contracts and subcontracts in foreign countries.⁸³ Like the Longshore and Harbor Workers’ Compensation Act (1927), whose provisions incorporate by reference and extends outside the continental U.S., the DBA was meant by the Congress as a compromise: «a compensation law through which employees are compensated for injuries occurring in the course of their employment without regard to negligence on the part of the employer or contributory negligence on the part of the employee» in return for «abolishing liability on the part of the employer except for the payment of the prescribed compensation»⁸⁴. Whenever the DBA applies, its benefits «are extended through the operation of the [WHCA] [...] to protect the employees against

⁷⁶ Cf. Congressional Budget Office, *Contractor’s Support of U.S. Operations in Iraq*, op. cit., p.14, according to which the costs of PMSCs in Iraq «did not differ greatly from the costs of having a comparable military unit performing similar functions. During peacetime, however, the military unit would remain in the force structure and continue to accrue costs at a peacetime rate, whereas the private security contract would not have to be renewed». See also WILLIAMSON, 1999, supra n. 18, at. 338.

⁷⁷ See Testimony of the Inspector General, Office of the Special Inspector General for Iraq Reconstruction (SIGIR), *Oversight: Hard Lessons Learned in Iraq and Benchmarks for Future Reconstruction Efforts* Before the Subcommittee on International Organizations, Human Rights, and Oversight of the Committee on Foreign Affairs, United States House of Representatives.

⁷⁸ Supra at n. 76.

⁷⁹ FRANCONI, *The Responsibility of the PMSC’s Home State for Human Rights Violations Arising from the Export of Private Military and Security Services*, EUI WP AEL 2009/18, at 2.

⁸⁰ Supra, n. 63 and accompanying text.

⁸¹ See COCKAYNE, 2007, at n. 15; SCHOONER, 2005, at n. 25; MINOW, 2005, at n. 2005.

⁸² HOPPE, EUI WP 2009/03.

⁸³ The contracts subject to the DBA are required to provide insurance coverage for such risks and potential compensation on behalf of its employees (FAR 28.305, 52.228-3 or 52.223-4).

⁸⁴ S.R. REP. No. 69-973, at 16 (1926).

the risk of war hazards (injury, death, detention)» (FAR 28.305 (c)). Under the DBA-WHCA-FAR provisions contractor personnel deployed in theaters of operations to perform «public work» may qualify for workers' compensation if *accidentally* injured, killed or missing while deployed, whereas the claims raising out either intentional or expected events are open to whatever means available under the common law.⁸⁵

In theory, the method of compulsory insurance is consistent with an approach led by market considerations. Once the PMSCs are deemed a desirable, indeed a *necessary* completion of the public army, the imposition of a veto upon contractual arrangements designed to shift the loss from the workers to the industry almost intuitively follows from the observation that the latter is by far the better cost avoider, as it is better informed on what the cost of accidents would be and can insure more cheaply. In practice, however, this choice rests upon the unproven belief that military and security services are not intrinsically different from any other service exchanged on the market. In other words, it deliberately discounts the potential for the loss of control associated with the privatisation of functions instinct with a sovereign interest, the difficulty of setting up a system of management oversight and to ensure that agency officials retain control over and remain accountable for policy decisions based on PMSCs' performance and work.

It should not come as surprise, thus, that U.N. Report on the *Use of mercenaries* has found that many PMSCs registered in the U.S. do not abide by the compulsory insurance provision.⁸⁶ Further, and particularly when the employees are «discount soldiers», recruited among the local population or in developing countries, a «labyrinth of contractual and insurance layers»⁸⁷ *de facto* shifts on the employees the costs of accidents. In this case the contractors are typically selected by a local intermediary agency on behalf of a company registered in the U.S., which in turn act as the agent of a major PMSC for hiring and training the personnel. Not less than three intermediate contractual levels, and a web of insurance policies, lay between the U.S. Government and the personnel dispatched to Iraq or Afghanistan as «independent contractors», making extremely difficult to enforce the insurance policy.⁸⁸ It certainly does not help, when the victim is a non-U.S. national, that the disputes arising from the contract must be settled by a U.S. court.

Even when the claimants are American citizens, on the other hand, recovery is difficult, given the massive recourse to unconscionable contract terms, such as the disclaimer of liability also for the harms caused or generated by the company, with the clear aim to bar the availability of common law remedies beyond the DBA limitation to «accidental» events.

It would be theoretically possible for the Administration to dictate stricter requirements for adequate insurance of employees and contractors; specify the allocation of responsibilities between the PMSC and subsidiary companies; define the pay and employment conditions of local and third nation contractors; clarify the respective domains of statutory remedies and common law, etc. If the central thesis of this paper is correct, however, these changes are unlikely. Seven years on the beginning of the «War on Terror», the Administration is not even able, or willing, to keep track of killed, missing or wounded contractors in Iraq and Afghanistan.⁸⁹ According to a rough calculus based on Department of Labor insurance claims, 1,292 contractors had been killed and 9,610 wounded as of April 2008 in Iraq and Afghanistan. With the escalation of the private branch of the military the market for DBA insurance skyrocketed: «From a somewhat small and insignificant part of the casualty insurance business line—government-wide DBA premiums paid to the top four DBA insurance carriers totaled \$18 million in 2002—it grew over twentyfold to a major market segment covering almost 200,000 prime and subcontractor employees and generating annual government-wide premiums of more than

⁸⁵ See the thorough analysis by the District Judge in *Fisher v Halliburton*, S.D. Tex. March 25, 2010.

⁸⁶ UN Report of the Working Group on the use of mercenaries as a means of violating human rights and impeding the exercise of the right of people to self-determination, A/HRC/7/7, p. 21

⁸⁷ *Ibidem*

⁸⁸ UN Report of the Working Group on the use of mercenaries as a means of violating human rights and impeding the exercise of the right of peoples to self-determination, A/HRC/7/7/Add.2 4 February 2008.

⁸⁹ SCHOONER, Why Contractor Fatalities Matter, 38 Parameters, 78 ff. (2008).

\$400 million».⁹⁰

The removal from the public eye of contractors' casualties goes beyond the constitutional right to a thorough information concerning the real human and economic costs of the war. It involves the division of powers between the legislature and the executive branch, as reliance upon contractors allows the Government to circumvent the power, granted by the Constitution to Congress, «[t]o raise and support Armies [. . .] [t]o provide and maintain a Navy [. . . t]o make Rules for the Government and regulation of the land and naval Forces [. . .]».⁹¹

Plainly, the Administration is not eager to boldly enforce a regulatory scheme whose costs, directly proportional to the share of PMSCs in the performance of military operations, are ultimately passed on to the taxpayers. The veil of ignorance laid on contractors' fatalities is consistent with strengthening the discretionality of the executive branch as to the choices concerning the warfare, while perpetuating the myth of the inherent superiority of market over hierarchies. The ultimate result is the hidden shift of the cost of accidents from the industry (and American taxpayers) to the workers. *Mutatis mutandis*, the identical conclusion might be reached for a regulatory scheme based on compulsory third-party insurance.

Finally, even when the hiring state and its private security partners do not build an integrated structure, leaving some room to contract law, the mere existence of different goals *within* the hiring state implies the possibility of a trade-off when it comes to contract drafting and enforcement. A state, for example, may want to forgo a contract term concerning the monitoring of contractors' compliance with international human right law, if this is deemed to conflict with its foreign policy objectives, budgetary constraints, or internal policy considerations. Moreover, the terms negotiated *ex ante* will not necessarily be enforced *ex post*: defence procurement contracts provide a paradigmatic illustration of a transactional environment where «classical» contract law enforcement procedures (litigation and arbitration) are deranged by informal decision rules and sanctions (reputation).²² Accordingly, the trade-off between accountability and efficiency will go to the detriment of the former, unless the contract drafting and enforcement are removed from the exclusive control of the contractual partners, which in turn raises the question of a governance structure, beyond the contract itself, that is needed to control the contractual relations between the hiring States and their private security providers.

The Limits of the Market for Force

This paper has addressed some of the (actual) limits and (conditional) advantages of governance by contract in the public procurement of military and security services. The difficulties faced by traditional, «vertical» regulation have provided an incentive to turn to market mechanisms. Contract standardization has taken an eminent place in this strategy, as it fits the transnational character of the industry, exploits the knowledge of the upscale layer of the industry, improves the level of compliance by securing market participants' cooperation. Different proposals combine different levels of intervention (national vs transnational), contractual arrangements (single- or multi-stakeholder), types of organizations (again: single- vs multi-stakeholder).

The choice is hardly neutral. Depending on the level of the intervention and on the instrument chosen, standardization can work either as de-regulation, shifting the balance of power from sovereign entities to the industry, or responsive re-regulation, with an array of intermediate solutions.⁹² The proposals advanced so far roughly fit into one of the following categories: (i) contract standardization imposed and enforced at national level (with the collaboration of external international and non-governmental organisations for monitoring),⁹³ or (ii) in the framework of a baseline system of

⁹⁰ See Dpt. of Defense, *Acquisition Strategy for Defense Base Act Insurance. Report to Congress* (Sept. 2009).

⁹¹ Cf. US Constitution, article 1, section 8. See D. Avant and L. Sigelman, *What Does Private Security in Iraq Mean for US Democracy?* Paper prepared for the 2009 annNew York, NY 15-18 February, 2009.

⁹² CAFAGGI, *Rethinking Private Regulation in Cafaggi, Regraming Self-Regulation in European Private Law*, The Netherlands: Kluwer Academic, 2006, pp. 3 ff..

⁹³ DICKINSON, 2006, *supra* at n. 14.

international public regulation enforced at domestic level,⁹⁴ (iii) industry self-regulation promoted and monitored by the major trade associations (the British Association of Private Security Companies and the International Peace Operations Association) and possibly supplemented at national level by an independent authority.⁹⁵

Although each category provides useful insights on the market for military and security services, seen from an *external* point of view, as it were, they fail to consider the transactions *internal* structure: what are their key design elements and how do different types combine with different governance structures. Only after having answered these questions, it would make sense to address the issues concerning the regulatory process in charge of setting the rules: who should draft the standards (national vs transnational and public vs private regulators, or both), at which level are these to be enforced and monitored, should these processes be open to subjects different from the regulatees, and so on.

Drawing on a survey of the contracts concluded by the US administration during the first stage of the Iraq occupation and the comparative analysis of public and private organizations, this paper contends that the public procurement of military force by great sovereign customers of PMSCs takes place in conditions of high bilateral dependency, asset specificity, probity hazards, that taken together deter from traditional methods of contract enforcement (litigation and arbitration) and emphasize mechanisms based on reputation and hierarchy. Its main conclusions can be summarised as follows:

- (i) there is an inverse proportion between the extent to which PMSCs are integrated into the chain of command and the utility and feasibility of contract law as a regulatory instrument;⁹⁶
- (ii) to the extent that international human rights and humanitarian law concur to define the constitutional framework for the exercise of sovereign powers, the privatization of military and security services entails the distinctive probity hazard of circumventing the limits to the legitimate exercise to the use of force at national and international level;
- (iii) regardless of whether PMSCs are integrated into the military or not, contract drafting and enforcement are open to the possibility of trade-offs, to the detriment of the States' human rights and humanitarian law obligations.

One might be reminded of Niccolò Machiavelli's admonition against the «inutile et periculose» mercenaries' arms.⁹⁷ If we were to take Machiavelli – and transaction costs economics - seriously, the use of PMSCs by the States would be banned, or at least heavily regulated so as to reduce the scope of regulation through contract, *naïf* as this conclusion might sound to the advocates of privatisation.

A more realistic (though arguably less wise) strategy shall take into account the *protean* nature of the military firm - its tendency to fit the characteristics of its sovereign principal - and adjust regulation accordingly. Two broad policy guidelines flow from this insight.

As a general rule, the scope and content of an international regime based on standard contract terms should adapt to the properties of the actual transactions existing between a PMSCs and its sovereign customers. This can be achieved by (i) using continuity and asset specificity as proxies of the private security provider's integration into the military organisation and (ii) correspondingly limit contract law regulation to occasional and non-specific transactions. There is no point in drafting standard terms that the governments have no interest to enforce. The weakness of traditional contract enforcement mechanisms calls in this case for an improvement of administrative controls, non-contractual liability

⁹⁴ THÜRER & MACLAREN, 2007, *supra* at n. 14.

⁹⁵ BEARPARK-SCHULZ, 2007, at n. 16.

⁹⁶ *Supra*, Sect. 3.

⁹⁷ See MACHIAVELLI, *Il Principe*, Milano, 1998 [Firenze, 1532¹], cap. XII; engl. transl. by W.K. Marriott (1908, available at: <http://www.gutenberg.org/etext/1232>) pointing to what today would be defined a *probity* issue: «Mercenaries and auxiliaries are useless and dangerous; and if one holds his state based on these arms, he will stand neither firm nor safe [...]. The fact is, they have no other attraction or reason for keeping the field than a trifle of stipend, which is not sufficient to make them willing to die for you».

and hard-law regulation. In the U.S., the amendments brought by the Congress to the Military Extraterritorial Jurisdiction Act (MEJA) and the expansion of the Uniform Code of Military Justice (UCMJ) represent a step in this direction.⁹⁸ Further, the regulatory efforts should focus on measures aimed at bridging the gap between national and transnational levels of regulation, so as to open the hybrid organisation made up by the hiring state and its security providers to the claims brought by the victims (third-parties, workers and their families). The reaching of an international consensus over the obligation of PMSCs and their personnel to comply with IHL and human rights obligations, for example, would significantly expand the potentialities for a decentralized enforcement of international law through extraterritorial national legislation such as the U.S. *Alien Tort Claims Act*.⁹⁹ Since the major sovereign PMSCs customers are normally the States in which the firms are incorporated or registered as legal persons, the scope and effectiveness of this approach would be significantly enhanced by the expansion of the responsibility of the home states, according to the rules of attribution under international law.¹⁰⁰

On the other hand, the importance of contract law regulation raises as the degree of integration of the security firm into the public organisation decreases, reaching its *acme* when PMSCs are hired by non-state actors. A standard contract incorporating the existing legislative and self-regulatory best practices upon which an international consensus has been reached could be an effective complementary measure, particularly when framed in a system of transnational governance based on licensing and home state liability. Still, the structure of contractual liability would make of contract damages a second-best solution compared to straightforward liability in tort, the proper province of contract regulation in this case being confined to contractual design of licensing, third-party insurance and performance monitoring.

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⁹⁸ See, generally, 10 U.S.C. § 801, et seq.; 18 U.S.C. § 3261, et seq.

⁹⁹ See RYNGAERT, *Litigating Abuses Committed by Private Military Companies*, EUI Working Paper AEL, 2009/05.

¹⁰⁰ FRANCONI, 2009, *supra* at n. 79.

