ENGAGE

The Journal of the Federalist Society Practice Groups

Project of the E.L. Wiegand Practice Groups

Special Edition: The Templeton Debates

Volume 10, Issue 2 July 2009

Letter from the Editor...

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Volume 10, Issue 2 **ENGAGE** *July 2009*

Special Edition: Templeton Debates

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Making Sense of the Establishment Clause

George Washington University, February 18, 2009

Jeffrey Shulman*: While the jurisprudence of the Establishment Clause may not make much sense (common or otherwise) as a substantive legal matter, it does make sense as a series of jurisprudential maneuvers by which the Court has sought to make more room for religion in civic life. In fact, there is a method to the "massive jumble... of doctrines and rules" that forms the law of church-state relations. It is the method of a somewhat disorderly retreat from the Constitution's foundational principle of disestablishment. The accommodations made by the Court to religious belief and conduct have allowed for discrimination against non-religion, edging the Court ever closer toward a non-preferentialist perspective.

Or, perhaps more precisely, a nominally non-preferentialist perspective. For the Court's accommodating attitude is premised on the privileged position of normative religious belief and practice. By adopting a majoritarian approach to church-state controversies, the Court has joined the power, the prestige, and the financial support of the government to the conventional theism that dominates our cultural heritage.

But, in constitutional law as elsewhere, we should be careful what we ask for. As the Supreme Court continues to retreat from a position of separationism, the pressure to define religion—that is, to say what faith is entitled to government support and what faith is not—will inevitably increase. A broad definition of religion guarantees a wide variety of claimants for government support, including some whose beliefs will not be tolerable to adherents of more mainstream religious traditions. When witches and pagans can no longer be preferred as a matter of constitutional law to Christians and Jews, the political premises of non-preferentialism would seem to be poorly served; and in a strange twist of constitutional history, the very principles by which non-preferentialists have sought to support religious practice should prompt a reconsideration of the virtue of high and impregnable walls.

Like Benjamin Button, the Establishment Clause was born old. In 1947, it seemed that a strict separation of church and state was constitutionally required. The *Everson* Court can certainly lay claim to having established the high-water mark of separationist rhetoric, but though the *Everson* majority promised not to approve even the slightest breach in Jefferson's wall, the rhetoric of that decision receded before a tide of practicality. Justice Black's words delivered less than they promised, and, of course, the Court held that New Jersey's reimbursement scheme was permissible.

* *Jeffrey Shulman is Associate Professor, Legal Research and Writing, at the Georgetown University Law Center. From 1984 to 2005, he taught in the Department of English at Georgetown University. After graduating from law school, Prof. Shulman was an associate at Sidley Austin. His most recent publications include* The Outrageous God: Emotional Distress, Tort Liability, and the Limits of Religious Advocacy, 113 Penn. State L. Rev. 381 (2008), *and* What *Yoder* Wrought: Religious Disparagement, Parental Alienation, and the Best Interests of the Child, 53 Villanova L. Rev. 173 (2008).

The possibility that *Everson* breached the wall it purported to erect did not go unremarked. For Justice Jackson, the "undertones" of the opinion seemed utterly discordant with its conclusion. Jackson considered the absolute terms of the Establishment Clause to be necessitated by the unique volatility of religious controversy. In his words: "That is a difference which the Constitution sets up between religion and almost every other subject matter of legislation, a difference which goes to the very root of religious freedom." That difference, according to Justice Rutledge, required the court to create a "complete and permanent" separation of the spheres of religious activity and civil authority.

It is against this faith in the strength of good walls that we can chart the course of the Court's modern Establishment Clause jurisprudence. The post-*Everson* Court has sought some mechanism to make religion a part of the public business—that is, some way to read the Establishment Clause in less than absolute terms. The *Lemon* test reflects, in part, the separationist sentiment of the *Everson* dissenters, but it is a test that hedges its bets a bit too much. It objects to governmental action with a *principal or primary* effect of advancing or inhibiting religion. It objects to *excessive* government entanglement with religion. These qualifiers would lead (probably inevitably) to inconsistent results, and indeed they have. The purpose prong, too, is an invitation to messy speculation, if not outright guessing, about legislative intent and motive.

But if the much-maligned *Lemon* test is more subjective than its multi-part analytical structure might suggest, the endorsement test is truly fertile ground for shifting Supreme Court sentiment. Justice O'Connor's endorsement standard is a model of heavy-handed wordplay. Rather than ask whether the government has a secular purpose or whether the government action has a primary effect that advances religion, we now ask whether a governmental action communicates a message of endorsement or disapproval of religion. Endorsement is in the eye—or, perhaps more accurately, in the hurt feelings—of the observer. To focus on the government's communicative effect, however, is to render establishment law little more than a form of intuition or, to use today's vogue word, empathy. Worse, by substituting a vague, judicially defined majoritarianism for the purported neutrality of the *Lemon* test, the endorsement test erases the perception of anyone who does perceive endorsement. But government support of religion is no less so because the majority fails to perceive that conduct as an endorsement of religion. That fact can serve only to intensify the offense.

In this respect, in its implicit concession to the indirect coercive pressures of majority sentiment, the endorsement test is of a piece with other jurisprudential strategies by which the Court seeks to secure a constitutional accommodation with religion. Ceremonial deism (the notion that religious practices, through rote repetition, may lose significant religious content) is most obviously a concession to the religious norm. The ubiquity of a religious practice ought to testify to its continuing vitality, a power and a vitality that are seen whenever these practices

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are, in fact, challenged. But by some distortion of common sense, the pervasiveness of a practice becomes evidence of its innocuousness. After all, no reasonable person could object to what so many reasonable people say or do as a matter of course. A focus on history and tradition shares with ceremonial deism a common constitutional alchemy, likewise transforming what is unobjectionable to the religious majority into what is constitutionally normative.

Taken together, these accommodationist strategies, by permitting the distribution of government recognition and benefits to religious groups, have enabled the Court to adopt a *de facto* preferentialism in the name of neutrality and choice.

For, after all, it is misleading to speak of the religious majority as some sort of abstract entity. In our society, the religion of the majority is Christianity. The God of ceremonial deism, the God of our national traditions, the God who benefits the most from government recognition, is the God worshiped by Christians. To the extent that other religions worship some variant of a Christian God, the religion of the majority is theistic. Both Jews and Christians (and post Justice Scalia's *McCreary* dissent, we should add Muslims) can pledge their allegiance to one nation under (some version of) God. In fact, the erasure of other religions or other religious beliefs is nowhere better seen than when the Court denominates prayer—and, remarkable to say, the prayer's recipient—as nonsectarian.

On many occasions, the challenge to the accommodationist argument has come, naturally enough, from nonbelievers. But non-preferentialism stands for the proposition that the government may not discriminate among sects. Given that, could a believer who does not believe in God be constitutionally offended by, say, the Pledge of Allegiance? If so, then the Pledge would fail, even by non-preferentialist standards. Times and cultural norms change, and there will come a time when accommodationism is challenged by followers of nontheistic faiths. Indeed, that time has come, and it has come in part because the Court has determined that non-theistic systems of belief are, for constitutional purposes, valid religions.

The Court's traditional definition of religion was closely tied to a belief in God. In 1890, following Madison, the Court grounded its definition of religion on the existence of a divine creator (and on the obligation of obedience to divine will). Eventually, the Court would acknowledge that religion does not mean, or does not have to mean, theism. The most generous definition of religion given by the Supreme Court occurred in a series of decisions interpreting the Universal Military Training and Service Act (the "Draft"). For the *Seeger* Court, the fact that Congress used the expression "supreme being," rather than the designation "God," indicated that religious belief was meant to embrace all religions. Ready with a test for all occasions, the Court decided that "the test of belief in a relation to a supreme being is whether a given belief occupies a place in the life of its possessor parallel to that filled by the orthodox belief in God."

For the traditional idea of God, the Court substituted Paul Tillich's "God above God," the source of some affirmation of ultimate concern. It is the subjective nature of this standard that makes *Seeger* so strikingly generous. Following Tillich, the Court implied that everyone has an ultimate concern. In deciding that Seeger's belief was equivalent to that of the Quakers, the Court relied on Tillich's exuberant formulation of the test. This is Tillich: "And if that word 'God' has no meaning for you, translate it. Speak of the depths of your life, of your ultimate concern, of what you take seriously without reservation." This is not an "ultimate concern" test; it is a "your ultimate concern test." (Star Trekkies: take note.)

In response, lower courts trying to define what is and is not religion adopt a variety of what might be called low-threshold inclusion tests. The Court in *United States v. Myers* considered the defendant's claim that drug use was a central tenet of his religion. He belonged to the Church of Marijuana (he was, I think, the only official member of the Church of Marijuana, though I suspect that some of his beliefs are widely and enthusiastically shared). The Court presumed that the following sets of beliefs are religious: "Hari Krishnas, Bantus, Scientologists, Branch Davidians, Unification Church members, and Native American Church members (whether Shamanists or Ghost Dancers), Paganism, Pantheism, Animism, Wicca, Druidism, and Satanism, and what we now call mythology: Greek religion, Norse religion, and Roman religion." The Court asked the obvious question: Is anything excluded? Well, the not-so-obvious answer: alas, the Church of Marijuana.

This liberality threatens to undermine the accommodationist foundation of the Court's modern church-state jurisprudence. For the significance of religious conduct cannot be measured only by its continuing vitality for majority religious groups. That conduct may have a different significance for minority religions. For some, the continued use of theistic ritual may be highly offensive, and what was once a tolerable acknowledgment of beliefs widely held by the people of this country may amount today and tomorrow to the impermissible favoring of one religion over another. Moreover, if religious practice can lose its significance through rote repetition, it stands to reason that it could, under the right circumstances, regain spiritual vitality. If Satanists worship the archenemy of God, it's difficult to see how, from their perspective, government-sponsored use of God's name is not an endorsement of a particular religion, is not indirect, or fairly direct, coercive pressure to conform. It is equally difficult to see how the followers of God, faced with real religious opposition, will continue to invoke their deity's name with rote repetition.

Perhaps more disconcerting to the accommodationists on the Court is the fact that an expansive definition of religion undermines the political premises of non-preferentialism. If religion is meant to conserve public morals, it must first embody those morals. Thus, it is really public morality that defines true religion. Minority religious groups may be perceived as subversive of the public order (followers of Bacchus: take note), but on what basis could a non-preferentialist Court exclude them from public business?

My thesis is this: In a pluralistic society, non-preferentialism contains the seeds of its own undoing. The government must dole out its largesse with an even hand (or one must adopt, with Justice Scalia, a monotheistic originalism), but by providing support to diverse religious groups, the government ensures

that the drama of religious disagreement will be played out in the public square and at the public trough. That drama may be bound to continue, but the courts can and should contain it within proper constitutional limits. The place to start is with the recognition that Jefferson's wall stands in need of more than a little repair.

The Growing Clash Between Religious Freedom and the Gay Movement

University of Wisconsin, March 9, 2009

George W. Dent, Jr.*: I want to thank the Federalist Society for inviting me today. At many law schools only one side of the ideological spectrum is presented. Often the Federalist Society is the only organization that offers a diversity of viewpoints and debate, and I think that's extremely valuable.

Just a few years ago when I started mentioning the war between the gay movement and religious freedom, many people asked, "What war?" With the vicious backlash after the passage of Proposition 8 restoring traditional marriage in California, not many people ask that now. The war has escalated quickly. My law review article about it, published about three years ago, was almost 100 pages and 600 footnotes long. It is already out of date because of so many recent developments.

This is not a war that boils down to a single legal issue that might be resolved in a big showdown, an Armageddon, a Supreme Court decision that would resolve the issue one way or the other and in which one side would obliterate the other. Rather, it is being fought out in innumerable skirmishes over state laws, local ordinances, and workplace regulations.

I apologize in advance to those who find my coverage here superficial, but the complexity of the conflict makes that inevitable in a short talk. It also necessitates some gross generalizations about the warring parties. I will refer occasionally to the gay movement and religious traditionalists, but I realize these are not at all monolithic camps. There is a wide range of attitudes in each, so much so that it is perhaps dubious to refer to them as single camps. But that, too, is inevitable in a talk of this scope.

The starting point for religious freedom is, of course, the First Amendment of the Constitution, which says, "Congress shall make no law respecting an establishment of religion or prohibiting the free exercise thereof." However, as those of you who have taken constitutional law probably know, in *Employment Division v. Smith* the Supreme Court virtually gutted the Free Exercise Clause by ruling that the right of free exercise does not relieve an individual of the obligation to comply with a valid and neutral law of general application on the ground that the law forbids conduct that his religion requires.[1]

What this means, for example, is that a jurisdiction may, if it pleases, forbid all consumption of alcohol, even in the Catholic Mass and the Jewish Seder. In practice legislative exemptions from such laws are common, but they are not constitutionally required. On the other side, the Supreme Court has never ruled that homosexuality is a suspect category for purposes of equal protection. Accordingly, laws that employ that category, like laws limiting legal recognition of marriages to those between a man and a woman, are subject only to the lenient rational purpose test, which in most cases is easily met. Again, however, legislatures are free to afford equal treatment to homosexuality. They can also generally forbid discrimination on the basis of sexual orientation, and many state and local legislatures have done so.

In short, the Constitution as currently construed leaves a big range of legislative discretion in the clash between the gay movement and religious freedom. The Supreme Court could change that somewhat by expanding the protection of free exercise of religion or making homosexuality a suspect category or both. However, I don't think that is likely to happen in the next few years. And even if it does happen somewhere down the road, it will probably still leave a large range of legislative discretion. In sum, the war between the gay movement and religious freedom will probably drag on for decades in many battles, most of them small and local.

How should we start to think about balancing the competing interests in this war? Let us begin with the fundamental ideals that underlie our Constitution. Religious freedom was considered indispensible by the Founders.[2] Indeed, they made it the first liberty protected in the Bill of Rights,[3] so that religious liberty is often called the first freedom. By contrast, the Founders did not consider homosexuality worthy of protection. For the most part, they considered it odious, and it was a crime in most states. Of course, attitudes change, as we have seen with respect to race and gender, and I think it is appropriate for the Supreme Court to follow these changes. It did so in the *Lawrence v. Texas*[4] when it struck down laws making homosexual acts a crime. Most states had already repealed their laws against sodomy, and the laws that remained were almost never enforced. Those laws then became sources of arbitrary intimidation by law enforcement officers. The public reaction to the *Lawrence* decision is significant. There was some grumbling about the Supreme Court's reasoning, but virtually no agitation to reverse it. Contrast the reaction to the decision of the California Supreme Court requiring recognition of gay marriages, which the public overruled within months through a referendum (Proposition 8) amending the state constitution.

Likewise, society is gradually moving toward a view that many kinds of discrimination against homosexuality are improper—many, but not all. This is where the clash with religious liberty arises. In this clash one could, perhaps, embrace absolutely one side or the other. On one side one could argue that churches, synagogues, and mosques must not discriminate against gays in the clergy or refuse to perform gay marriages. On the other side, one could say that the public school principal may decline to hire gay teachers if hiring them would offend her personal religious beliefs. However, very few people take either of these absolute positions.

For most of us the question is how to draw the line—how to balance the competing interests. This requires delving into the details, into the relevant considerations that vary from one context to another. To take my two extreme cases, for example, a public school principal, or any public official, generally has no business hiring people on the basis of her own religious beliefs.

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On the other side, religious freedom means nothing if it does not allow a church to decide by what ideals its clergy will live.

What about the tougher situations? Consider first the private workplace. No federal law prohibits discrimination on the basis of sexual activity, although Congress is considering a proposed Employment Non-Discrimination Act (ENDA), which would add sexual orientation as a prohibited basis of discrimination in the civil rights laws. Many state and municipal laws already forbid such discrimination in employment. On the other side, Title VII forbids discrimination on the basis of religion.[5] However, Title VII does not require an employer to accommodate an employee's religious practice if the cost would be more than *de minimis*.[6] As a result, very few employer refusals to accommodate have been held illegal by the courts.

What does this mean in practice? Hewlett-Packard had a diversity campaign that included approval of homosexuals. An employee, Richard Peterson, indicated his views on this by posting, in his own cubicle, passages from the Bible condemning homosexuality; he was fired. He sued under Title VII and lost. The court said HP did not have to tolerate these postings because there were intended to be demeaning and degrading and to generate a hostile and intolerant work environment.[7] In effect, the court deemed the Bible to be hate speech. One wonders if Peterson has a right under the statute to indicate in *any* way his reservations about the company policy.

In this case, the policy was imposed by the employer, not by law. However, given the court's comments, the employer might have had to fire Peterson if there had been an antidiscrimination law like ENDA in place. At the least, an employer would invite a nasty, costly lawsuit by a homosexual employee claiming workplace harassment if the employer did not fire an employee like Peterson. Thus such laws are likely to lead employers to forbid any expression of religious disapproval of homosexuality, even if the expression is quite obscure.

Consider also two employees of an Oakland, California, public agency who posted on a bulletin board for such things a notice about their employee association that was "a forum for people of faith to express their views on contemporary issues of the day, with respect for the natural family and family values." The agency removed this notice, saying it contained statements of a homophobic nature that promote sexual orientation-based harassment. They, too, sued and lost.[8] One wonders whether the plaintiffs could have used any language that would have satisfied the court and still conveyed the purpose of their group.

Public schools and universities have also been frequent battlegrounds. Several universities have refused recognition to student religious groups because their membership criteria exclude students who condone homosexuality. It is not illegal for someone to eat meat or be a Republican, but a student vegetarian society or Democratic club can exclude such people because they don't support the group's objectives. Why, then, cannot a student religious group exclude those who do not share its beliefs? Fortunately, a few court cases have held that such university rules are unconstitutional, but the issue is far from settled.[9] Related cases have involved access to school facilities and funds.[10] Many colleges also forbid speech that might offend others on grounds that include sexual orientation. That, of course, puts a terrible chill on free speech. Fortunately, every such code that has been challenged in court has been struck down,[11] including, I'm sorry to say, one at this august university.[12]

K-12 is a different story. A California public school district decreed observance of the annual Day of Silence, an event intended to condone homosexuality. A student, Tyler Harper, opposed this, and on that day wore a T-shirt reading, "I will not accept what God has condemned—homosexuality is shameful," with a citation to the relevant passage from one of St. Paul's epistles. When he refused an order to remove the shirt, he was confined to the principal's office for the day. The next day he wore a shirt with a different but similar message and was sent home.

The Supreme Court has said that public school students do not shed their right to free speech at the schoolhouse gate.[13] They may express themselves, unless their expression would interfere with school work or impinge on the rights of others. On this basis, Tyler Harper sued and lost. The court conceded that students have some rights of free speech. It said, for example, that a school must permit a statement, "Young Republicans suck;" that would be constitutionally protected. But Tyler Harper's T-shirt could be barred because it attacked high school students who are members of a minority group that has been oppressed throughout history.[14]

Note that Tyler Harper, like Richard Peterson at Hewlett-Packard, did not initiate the discussion of this topic. They were both reacting to official activity—in Tyler's case, to official school activity that offended his religion. So in this case the court held, in effect, that the school can openly espouse one side of a public debate, then silence students who wish to dissent and say something on behalf of the other side of the debate, even though they were motivated by their deepest beliefs. Public schools, I thought, are supposed to teach children about liberty. What message do they communicate and what lesson do children learn when the public schools themselves suppress students' liberty?

A third contested area is government contracting. Many children available for adoption are easy to place. Catholic Charities of Massachusetts was for many years highly effective in finding homes for disabled, older, and unruly children who were much more difficult. Then, the Massachusetts funding agency ordered Catholic Charities to give equal treatment to gay couples that wanted to adopt. Catholic Charities' religious principles prevented that, and it could not continue without government money, so it closed its doors.[15] Note that there were other adoption agencies that were happy to serve gay couples. The state's action served only to destroy one of its most effective partners.

A fourth battlefield is government licensing and regulation of people trying to earn a living. In Los Angeles, a medical internist refused to inseminate a lesbian because of religious objections to inseminating an unmarried woman. When threatened with the loss of her license, she sued and lost.[16] The court ruled that she had no right to refuse treatment on religious

grounds. And in Albuquerque, New Mexico, the state sued and obtained a judgment against a photographer who declined to photograph a lesbian wedding.[17]

Note that the insemination case was not a medical emergency where a denial of treatment would have caused medical injury. In both these cases, the defendant was offering services that were readily available elsewhere in the community. In both cases, the complainants hunted down professionals whose religion did not condone the gay movement and invoked the coercive power of the State, not because they had been denied services they could not obtain elsewhere, but to force the defendants to publicly violate their faith. The goal overtly is to ostracize, to make pariahs of people of traditional faith.

The last war zone I will mention is use of public facilities. In several places, the Boy Scouts and similar scouting groups have been denied access to public facilities because they do not accept as Scout leaders anyone who rejects their moral code, which does not approve homosexuality.[18] The Scouts perform an important service. For many children whose lives do not offer much opportunity for wholesome recreation, the Scouts offer an outlet, a refuge. Shutting them down denies this opportunity.

There are other categories and many other cases I could mention, but I think I've given you some idea of the nature of this war. Let me return now to the basic question of how we should think about this war. First, all people deserve to be treated with decency and civility, and I think that discrimination based on sexual orientation is generally wrong and should be illegal in some cases, including employment in most government jobs and maybe in large private firms.

However, the situation of homosexuals now is very different from that of African-Americans 50 years ago when the federal civil rights laws were first adopted. For one thing, race is usually apparent just by looking at a person. Sexual orientation is not. Also, African-Americans did, and still do, lag far behind whites in income, while gays overall have average or above-average incomes. Discrimination is certainly often infuriating to homosexuals, but it is not a major systemic economic phenomenon.

On the other side, religious liberty has long been considered essential in America and in all free societies. America was peopled in large part by Puritans, Baptists, Quakers, Maryland Catholics and others yearning to practice their religion without government oppression. Again, religion was made the first freedom by the framers of the Bill of Rights, and since then America has often been replenished by refugees seeking religious freedom.

Religion has often played a leading role in our political history, including the Abolition and Civil Rights Movements. And religion has often been a basis for exemption from general legal obligations, even onerous ones, like the conscientious objector exemption from military service even in times of war. So laws forbidding sexual orientation discrimination should not be drafted or construed to forbid individual expressions of religious belief and exercise of religious conscience in such times, places, and manner where expressions of opinion and actions about, say, politics and sports would be permitted.

Where antidiscrimination laws do apply to smaller private organizations, there should be an exemption not only for churches but for organizations like Catholic Charities and the Boy Scouts that have a religious orientation, unless they provide important services that are not available elsewhere.

That is just a brief, general sketch of a proposal that I have worked out in greater detail in writing and hope to continue to develop, but I think I have given you an idea of what the issues are and of my own views on them.

Thank you.

Endnotes

1 494 U.S. 872, 879 (1990).

2 *See* John H. Garvey, What Are Freedoms For? 49-57 (1996) (describing the importance of religious freedom to the Founders).

3 U.S. Const., amend. I.

4 539 U.S. 558 (2003).

5 42 U.S.C. § 2000e-2(a) (2000).

6 Trans World Airlines, Inc. v. Hardison, 432 U.S. 63, 84 (1997).

7 Peterson v. Hewlett-Packard Co., 358 F.3d 599 (9th Cir. 2004).

8 Good News Employee Ass'n v. Hicks, No. C-03-3542 VRW, 2005 WL 351743 (N.D. Cal. Feb. 14, 2005).

9 *See* George Dent, *Civil Rights for Whom?: Gay Rights Versus Religious Freedom*, 95 Ky. L.J. 596 (2007). *See also* Truth v. Kent Sch. Dist., No. 04-35876 (9th Cir. 2008) (holding that a public school may refuse to recognize a student organization based on religion).

10 *See id.* at 608.

11 *See id.* at 603-08.

12 *See* UWM Post v. Bd. of Regents of the Univ. of Wis. Sys., 774 F. Supp. 1163 (E.D. Wis. 1991).

13 Tinker v. Des Moines Indep. Cmty. Sch. Dist., 393 U.S. 503, 506 (1969).

14 Harper v. Poway Unified Sch. Dist., 345 F. Supp.2d 1096 (S.D. Cal. 2004), *aff'd*, 445 F.3d 1166 (9th Cir. 2006).

15 *See* Patricia Wen, *They Cared for Children: Amid Shifting Social Winds, Catholic Charities Prepares to End Its 103 Years of Finding Homes for Foster Children and Evolving Families*, Boston Globe, June 25, 2006, at A1.

16 North Coast Women's Care Medical Group v. San Diego Super. Court, 189 P.3d 959 (Cal. 2008).

17 Willock v. Elaine Photog., (N. Mex. Human Rights Comm'n 2009), *available at* http://volokh.com/files/willockopinion.pdf (last visited May 18, 2009).

18 *See* Dent, *supra* note 9, at 592-95.

Responding to the Financial Crisis

University of Chicago, October 10, 2008

Anupam Chander*: I am grateful to the Federalist Society for convening us here on a timely and crucial topic. Given that I am speaking to law students, let me begin with a story I heard when I was a law student. The story is undoubtedly apocryphal, but it's funny and instructive nonetheless. A law professor was getting married, and his bride-to-be went to get her hair done. She returns home, but unfortunately the cut has gone awry. The professor then goes to the salon and angrily demonstrates his displeasure. The police are called and they take him to jail. The story, as told, is that he gets on the phone with his law professor colleagues and asks them to bail him out. And they all admit, in seriatim, that they don't know how to do it.

My point is that it's important for lawyers to know something about bailouts. This is a subject that we often leave to business men and women, but it is imperative that we discuss this subject here, in law schools, and not just across the Hyde Park Midway at the business school. We cannot afford to rely upon the expertise at the business school alone to get us out of this mess.

What are some of the basic legal issues before us? I will identify three. First, there's the well-known principal-agent problem; that is, the people who own the assets don't share the same incentive as the people who actually run the companies, who make the decisions on a day-to-day basis. The disconnect between the incentives and interests of the principal and agent are something that we lawyers know a lot about, and we have designed common law and corporate governance structures to address this problem. In our current predicament, private bankers, people on Wall Street, people at Chicago hedge funds, etc., made the decisions, but often not as the actual proprietors of the assets with which they were dealing—yet still pocketed enormous profits on a short-term basis. So over the last handful of years you could make a million dollars on the risks undertaken yet not be the one left holding the bag when the value of Lehman Brothers dwindled to zero. Much of that compensation was in the form of options, with the hope that that stake would ameliorate the principal-agency problem, which apparently it did not do sufficiently. We lawyers are the professionals best positioned to structure long-term relationships to address the principal-agency problem.

A second important factor familiar to lawyers is the concept of moral hazard, the notion that those who are actually undertaking these activities are insured from the risks of those activities. Again, we lawyers are the ones who design structures to deal with moral hazard. How do we make sure that people don't make such foolish moves in the future? How do we internalize the risk, not externalize it to all of us?

Third, there's an international aspect to this problem, to which Todd averted with the mention of China. Financiers don't really care about borders. They only care about where the highest rates of return (given the risk) are. The regulatory structures, on the other hand, are national in scope. Borderless capital needs regulators who cannot be easily foiled by the water's edge, allowing either a race to the bottom or regulatory arbitrage. Coordination among governments in this area is yet in its early stages. Just yesterday, the United States rejected a proposal by the European Union that we agree to back up interbank lending. The Europeans had said that we should all guarantee interbank lending, much of which happens to occur in London and profits bankers there. These are issues that lawyers are particularly adept at—thinking about who governs and who needs to be held responsible in these kinds of situations.

In addition to the legal nature of the issues at stake, there is the fact that lawyers are involved in both creating the problems and fixing them. Who created these innovative structures in the first instance? It was bankers working with accountants and lawyers. We were a crucial leg in that three-legged stool. When these complicated financial structures were created we could not responsibly have said that it was someone else's responsibility to understand them. Tom Harkin reminds us of how we once spoke of Alan Greenspan—as though he were an oracle, as though we could not and should not question the economic experts. But we cannot afford to hive off economic and financial issues from the law and other areas of life. One of the crucial things you learn as a practitioner is to not just take the words of bankers and others as oracular statements not susceptible to the understanding of ordinary mortals.

Finally, as I said, we might be the ones called upon to solve these problems. As it turns out, Barack Obama is a lawyer. Robert Rubin, who solved similar crises abroad during the last decade, is a lawyer. The crucial players in many of these instances are lawyers. And I'm happy to see that you are all here to think about these things and help prevent them or resolve them in the future.

M. Todd Henderson*: Let me add a couple of comments, and then I will add a macroeconomic element to this discussion.

There's this country called China. And we like things that are made in China, and so we send them $500 billion in cash, actual dollar bills, every month—roughly. They get it, but what can they do with it? Well, they can't give it out to their citizens, because you can't buy things in China with dollars. So they've got to invest it. Well, this is a nice thing, because it's going to come back to us in investment. But what can they

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invest in? Well, they have three choices—let's say there are three choices—only three things in the world that one can invest in. One is the U.S. Government, the other one is houses, and then of course there is Google. They've now taken over and own everything in the United States in terms of production.

So now China can invest in one of these three things. Historically, they invested in the U.S. Government, something called Treasury bills. The Government would sell these bills, China would give us $500 billion, and that's how we paid for No Child Left Behind and killing people in Iraq. That's what we do with that money. But the problem was that after 9/11, Greenspan lowered interest rates, so the interest rate to borrow money went to nearly zero. This was a loose monetary policy, inflationary credit policy; that is, money was very cheap. This is what first got us into our problem, and it's funny because we're now lowering interest rates to get ourselves out of it.

But China doesn't want to invest $500 billion in something that's going to give them a one-percent return. They can invest in Google, since Google has something like a 100-percent return in recent years. So this is the future of China. They don't trust Sergey and whatever that guy's name is. They could use the $500 billion to buy the Portland Trail Blazers, but what good would that be to China?

But what about houses? Someone comes to them and says, look, you can invest in U.S. houses and, because of what Douglas suggested, the return on these things is 10, 15 percent, and "wink wink"—this is Uncle Sam winking at China—this thing Fannie Mae is backed by the U.S. government—if it fails, the government will bail you out. That is, China becomes basically a bondholder of Fannie Mae, and we promise to bail them out, which is exactly what we did.

So you have a situation where you have an implicit promise from U.S. Government that they can invest in these securities and earn returns that are higher than what they should be, because they're not bearing the full risk. What does that mean? That means that this money is funneled to houses. That is bad government policy, it is social engineering gone awry, this pressure to push people into houses. What is so good about homeownership? It doesn't make any sense. The entire social policy, from mortgage interest deduction to encouraging subprime lending, is terrible. But you know, bad government policies exist everywhere. The real problem is when you add bad government policy to the natural greed of human beings.

The natural greed of humans is always there and always in the background, but when bad government policy gets into the mix, hold onto your wallets. It is fire and fuel, and we have seen this innumerable times in American history. The greed of people who can make money based on these implicit government promises is enormous. As a consequence, we had a huge investment in this country in houses that turned out to be not worth so much. And you had people who took real equity out of their houses and bought things like plasma TVs and flipped houses, and the stuff just was not worth what it appeared to be worth.

So, we have bad government policy coupled with the natural greed of people who were investors—all of us, anybody in here who wanted to flip a house, anybody in here who ever thought they could invest in a condo with no money down, all the mortgage brokers who were cheating and scamming people and making $85,000 a month. These people proliferated during the boom time. And now, we have to figure out what we're going to do with this huge over-investment in houses. One option would be just to let all the banks just fail—let the U.S. government fail for that matter, and watch this entire welfare structure, a house of cards just like the housing bubble, come crashing down in a real reckoning. But that would be really painful. That's cats and dogs living together, mass hysteria; terrible. The harm would be enormous. It's the error end of the curve. We might come back up, or try to preserve the bleeding and drag it out like we did in the New Deal, but I think the reason for the bailout—the reason I feel the Government has to do something—is because we don't live in a world where everybody takes their reckoning and people are punished for their bad mistakes. We don't live in this hypothetical world. There are real social consequences for letting people fall, letting people out of their houses. And the human cost could be enormous.

It reminds me of Milton Friedman who, once at a dinner party in the living room I now own, was ranting against rent control, and a little old lady from Hyde Park jumped up and said, Milton, are you really going to throw these people out of their house? And he said, no, of course not. This is in theory; we should try to do away with rent control, but we can't. We're stuck in the world that we're in. And I, too, think we're stuck in the world we're in.

The reason Government wants to bail out Wall Street, as opposed to letting these banks fail and new ones arise to connect lenders and borrowers, is that we need money from China. China is not investing, and we need China to invest. If Goldman Sachs and Bank of America fail, China is not going to give money to the Baird & Henderson Bank to give to people. The reputations and potential costs of that are too high for them.

So the $700 billion is a way of building a bridge between borrowers and lenders, but our bridges have holes in them and it may take us a while to get to the point where people feel comfortable crossing those bridges again. This is us repairing broken bridges in an attempt to salvage and stifle the human misery. I think, sadly, the consequences for short-term benefits are potentially long-term gain, but we could talk more about that.

Rosalind Dixon[*]: How you frame the bailout has a big impact on how you think about solutions. I think Professors Henderson, Baird and Chander all had a very good theory—certainly a lot better than, well, the President—about what has caused this crisis. But I'm going to add something to what they said. I think they found their "answer" to how to think about

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the bailout by framing the underlying problem which caused it in a way that leaves out one piece of the puzzle. Professor Baird [not included] basically told you that if the people who price credit derivative swaps—i.e. the guys (and girls) at Standard & Poor's—were just a bit smarter and a bit more careful, we would not have inherited this problem. Professor Chander said, well, you know, actually the problem was about moral hazard… it was because the banks were subject to moral hazard, and the guys at Standard & Poor's also, that we face this crisis. On this view, we just need a few more University of Chicago law students to work at Standard & Poor's, or better tailored incentives for bankers and S&P employees, in order to avoid the problem in the future.

Well, that's surely one part of the answer. Professor Henderson's diagnosis of the problem also adds another potentially important lesson for the future. He tells us that what happened in this area was that bad government policy hooked up with greed on Wall Street. Good policy in this area, according to Professor Henderson, might be allowing really poor people to get a very concrete and relatively small transfer to allow them to have a home. The really bad policy, in his view, was allowing people who did not live in those homes, who were not really poor people, to get access to Fannie and Freddie funds in order to have second and third condo investments, which they weren't going to be able to repay. And because it is hard to figure out how to prevent similar forms of bad policy from happening again in the future, his solution seems to be, don't let government policy get hooked up with the private sector.

That is troubling to me as a general prescription, and I think it creates a very strong tilt in the future towards a much more limited form of government intervention than is justified, regardless of your substantive preferences around a particular set of policy demands.

It also ignores one important factor we can identify which contributed to us ending up with such a bad housing policy… ; namely, a lack of transparency. As Professor Henderson himself said, one of the causes of this crisis was a form of subsidy that was completely hidden to the American people—no one went to the polling stations in 2000, or 1990 for that matter, saying, I'm really worried about housing subsidies. This was a form of extremely non-transparent public policy, and it had very damaging consequences.

There is another way in which transparency and poor oversight and regulation were essential to this story. A major cause of this crisis was the degree to which banks became over-leveraged, and came to hold highly inter-connected portfolios of credit default swaps, and all this happened with very, very little public disclosure, knowledge or oversight. The current law imposes very few disclosure requirements in this area, and almost none of the investment banks or hedge funds engaged in serious voluntarily disclosure. And so it was extremely hard for people to figure out how leveraged financial institutions were and how much they were using [certain] extremely risky assets that had been misvalued as part of their total asset base for the purposes of leverage. No one could figure out what they were doing in a way that made the market unable to price assets appropriately or deal with them in an appropriate, qualified way. This led to the result that, as Professor Baird said, a relatively small miscalculation in the value of particular assets had very large flow-on effects….

Once you see the problem in this way, part of the solution is to insist that investment banks should convert themselves into a commercial bank structure, and therefore be subject to a maximum leverage ratio of something like 8:1 instead of 30:1.... Another part of the solution will be to impose increased transparency requirements across the board, so that in the future, the mispricing of assets is more likely to come out and the market to punish it at earlier stage, so that the mistake doesn't spread and multiply through the whole economy, as it has in this case.

So to me, it is important to recognize that there's a connection between how we characterize the causes of the current financial crisis and how we think of solutions. There were probably lots of causes, but which ones we elevate above others will have important ramifications for how we address the problem in this and related areas.

Having said that, I don't think that there is a perfect correlation between identifying the cause of the problem and the solution to it. It may be that lowering interest rates post-9/11 helped cause the current problem, but it might still be the right thing to do to further lower interest rates in order to help correct the problem. It may be that we put too much money into housing to begin with, which is what helped create the problem, but that the right thing to do is to put more money into housing, which is effectively what the bailout is doing. It may also be that moral hazard, as Professor Chandler said, helped caused the problem, and that the bailout itself creates more risk of moral hazard problem, because it tells people that if they take risky behavior, they may be bailed out after the fact, but that that it is still the right thing to do. So there's a certain trap here, of getting too fixed on avoiding the mistakes of the past.

Lastly, I want to say that I think this is an area which crosses partisan divides, and which requires us all to try and see the other side of the story. Some people insist the derivatives are largely good, and so you shouldn't regulate them. Others insist that, because there has been "bad" trading in derivatives, we should be against derivatives generally. There is an article on the front page of the *New York Times* arguing that the problem in this area was that Greenspan had too much faith in derivatives. But derivatives are an enormously helpful and important financial instrument. As the Federal Reserve said, the insurance they provide to purchasers is extremely positive from a welfare perspective. But once you have derivative markets of the kind we have been talking about, you get massive speculation. Speculation itself can be good because it creates liquidity in the market, but it also means that real oversight must be there, because tiny distortions in the market can have massive flow-on effects.

The Economic Crisis: Wall Street, Main Street, or K Street?

Fordham School of Law, October 23, 2008

Introductory note (Richard A. Epstein): This talk was given on October 23, 2008 in the midst of the credit crisis that was gripping the nation at the time. I had the opportunity to edit it at the end of June 2009 and am sorry to say that the predictions have proved true. The bailout process itself has become ever more politicized for ordinary businesses, including Chrysler and GM. A huge stimulus package has been put in place, which makes it difficult to spend the allocated funds in a coherent fashion. The Congress is considering ambitious new schemes of financial and health care regulation in the face of rising deficits and government expenditures. The President and the Congress are united in the belief that dangerous times require more government action. The stock market remains about where it was on January 1, 2009, and the unemployment rates have moved higher still. I regard these events as vindication of my gloomy assessment, which I don't think is likely to prove false in the short run.

Richard A. Epstein*: It is an honor to be here. I'm happy to see so many people have come to make judgments about our economic situation. Usually people in economics, or in law and economics, do not lack the confidence to talk about the major problems of the day. If this talk were a discourse on antidiscrimination laws or the minimum wage or some similar conflict, I would be situated clearly in the camp for deregulation. But money and credit and all the related topics are much more difficult to get a grip on. Therefore, I think you have to be aware of the two extremes, in order to try to find some way between the poles. This puts me in the uncharacteristic position of being a moderate, but so be it. I will bear that scorn with whatever dignity I can summon.

What are the two extremes that we have to fight against, or at least, to think hard about? Well, one is the strong libertarian position, which says any time people enter into a financial market or transaction, they know the risks. If therefore it turns out that they miscalculated, they should be allowed to fail. That, libertarians say, is the only way in which the whole system can be kept in equilibrium. Otherwise, we the people, through our government, are forced to provide massive amounts of subsidies, or to create distortions of one kind or another. By throwing good money after bad, government makes the whole situation systematically worse than it ought to be.

I think there is some truth to that particular proposition, and one ought never to ignore it. But the complexity of these interlocking transactions and the dangers peculiar to bank loans and other collective phenomena caution against the belief that mass transactions are governed by the kind of logic that normally applies to isolated or uncorrelated transactions. The two do not function in exactly the same way. So it may well be that the kinds of responses we need are different.

On the other side, many on the liberal wing of the political spectrum take a different view; for example, my friends who quote Barack Obama that the source of all evil in the credit market is in the "massive amounts of deregulation" that has taken place. There is an acerbic version of this position in a recent issue of *Slate* by Jacob Weisberg, who basically calls all libertarians—a term which is very dear to my heart—immature intellectuals who are fixated on novels by Ayn Rand,[1] which, I might add, I have never read. Weisberg believes that the case for regulation is so self-evident that anybody who opposes more state control is simply going to repeat past errors or create still greater economic crises. The opponents of additional state control ought therefore to be utterly disqualified. His basic attitude towards folks like me is: "You've done enough harm, now shut up and be quiet." The current fight indicates that in situations of major peril, name-calling seems to take over. But what we need to do is to put this aside to get back to figuring out how the system is put together.

The metaphor I like to use is medical. It turns out that the diagnosis of conditions is, in fact, quite difficult. Many times people die because they need an "upper," but they're given a "downer" because the underlying physiologies of a particular ailment are quite different, even though two manifestations of it are quite similar. And so you have to be extremely astute in figuring out the causes so that you don't aggravate the problem.

But just because you can make a diagnosis, it doesn't follow that you can actually propose something that works as a cure. What we're saying here is that no amount of human ingenuity can reverse the natural biological processes. Certain societies get themselves into such a tailspin that it's probably the case that no amount, and no form, of financial intervention will be sufficient to undo the damage at the end of the day.

The usual response to crises such as the present one is some kind of a government bailout, on the premise that the ship of state will always be above water, even after it has taken on extra baggage by its various obligations. As we know, however, one can never think about government interventions as something that does not create additional systematic risks of its own. There is no risk-free alternative. One of the things I would like to stress is that, in the effort to control various localized risks through some kind of general and comprehensive government solution, we may be systematically increasing the probability of a much larger risk. That system-wide risk may be low just now, but as the TARP gets bigger, one has to multiply and realize that a low probability of enormous risk may in fact be far greater than a higher probability of a somewhat smaller one.

So how is it that we start to diagnose such a crisis? Well, the first point I want to make is that in today's world, there is no such thing as a private market transaction—no matter how much you might like to think so. This calls attention to

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a feature of most business transactions that we might like to neglect, which is the role of money in a system that is driven by voluntary sales.

In the good old days, money essentially took on the following form: People would have something like gold, and they would store it with a trusted party for safekeeping. And they would receive in exchange a certificate that allowed them to redeem their gold upon presentation. By degrees these certificates became money, by being freely alienable from hand to hand. But the users of these certificates had to make sure that people could not fraudulently counterfeit the various receipts, which meant that someone had to make them a little more, shall we say, complicated. And when these certificates circulated in society, the great advantage of having this big store and clamping down on counterfeiting was that people knew that the supply of currency turned out to be fixed, and so therefore it was relatively free from various forms of government regulation.

There are difficulties with this system. If you tie your monetary supply to a commodity like gold, and gold itself is subject to market fluctuations, it may well be that you can't inflate the currency by adding more of these certificates of deposit to the mix. But if the underlying currency tends to be worth less and more on alternative days, you lose stability in another dimension—that of valuation fluctuation—which in fact will make these private transactions much more difficult. What happened in most modern societies is that people said, "Look, we cannot figure out how to make a commodities-based monetary system work, so we have to get—create by fiat—a government currency." When you go back to the first efforts at government currency, you find that nations always sought to have the government hoard gold in Fort Knox or the New York Federal Reserve Bank or some place of the sort; they still keep supplies of it. But sooner or later, the amount of the commodity as a fraction of the total amount of wealth in society shrinks. So you have certificates that are not backed by gold, and you must find some other way to limit the amount of those certificates that move in commerce, because otherwise you have to put terms in various contracts in pricing terms, where the ruler by which price is itself is inconstant. This is no small difficulty.

Many of you have heard about the Great Depression, but most people do not know about the great deflation that accompanied that economic crisis, which triggered so much of the difficulties. Under the stalwart Herbert Hoover, and Franklin Roosevelt later, the money supply was allowed to contract so that every debt denominated in fixed dollars was much costlier to pay off than had previously been the case. This prompted all sorts of difficulties in the foreclosure market, which in turn prompted all sorts of efforts to create moratoria. Of course, it sounds wonderful, to keep debtors who can't possibly pay their debt on the premise that the banks will be just fine. But all of a sudden, depositors understood that they were not going to be able to redeem their demand accounts, and nervousness set in. Once that took place, we had the run on the banks.

This risk is not one that is going to disappear. To give you an example, when I attended a securities regulation conference on the bailout a couple of weeks ago, here at NYU Law School, I was asked if I knew that the major money market funds were running the risk of breaking the buck. I looked at my fellow panelists and said I don't even know what that expression means. Well, it means that there's no safe place to keep your money. We put our money into various accounts, which we can redeem in part any time we want, dollar for dollar. But if the money goes into commercial paper, which itself depreciates in value, there is now a risk of a run on Fidelity. "Breaking the buck" means that the money market fund or similar organization will say there is so much money being demanded of us now that we can only redeem $.99 or $.98 or $.97 on the dollar. The moment you break the buck and go down below that par level, it's clear a run can easily take place, and the redemptions could be at a much, much lower level.

What this suggests is that there is a very low probability of an absolutely catastrophic event. People thought their money was "safe" in these accounts, which were substitutes for savings deposits at one time or another. But they were not. In fact, one of the reasons this current financial situation is so totally neurotic is that at the present time, given the various bailout strategies, we do not know whether we have to fear deflation or inflation. It could be either or both in fairly rapid succession. Generally speaking, your ability to price all sorts of transactions becomes weaker and weaker as the level of uncertainty starts to increase with respect to the basic money supply.

So, there are reasons for the enormous uneasiness about Wall Street, but you have to understand that there is no safe haven. You cannot get it in commercial paper, nor can you get it in cash. It's quite possible on the cash side of a one-to-one redemption that the valuation risks we've talked about will come back, so that the dollar saved in fact will pay you nothing by way of interest and will depreciate at seven percent a year by virtue of some kind of rapid inflation. There is, to borrow a title from the French philosopher Jean-Paul Sartre, *No Exit*, no dominant strategy available to anyone, public or private, to insulate us from the risks of a depression. When you have major contractions in the total level of certain physical and intellectual property and tangible wealth, there is no way for anyone to say, "I wish to take a risk-free position, so I'm going to do X." You still have to diversify against the risks you normally do not think of being in play, but in fact are. This is not a really upbeat story, in case you haven't caught my drift.

So what happened? Well, as I indicated to you before, when you have a financial transaction and the money valuation is insecure, people per force are exchanging goods under unreliable signals. The usual libertarian argument, that *voluntary* exchange is the greatest mechanism for wealth creation in the history of the world, is true. But if the monetary ruler is screwed up, every single voluntary transaction in the system has a gratuitous amount of uncertainty.

The great achievement of Milton Friedman, a name taken in vain too often lately, was not so much his stuff on the free market, but his work on monetary theory, a quintessential government area.[2] Friedman was able to devise a set of protocols that essentially allowed for money to keep pace with the increase in the level of goods, so that instead of having deflation of the kind we had in the 1930s, or inflation of the kind we had in the 1970s, we have had, since about 1980 or 1982, a relatively

constant money supply relative to the size of the economy. This means, in effect, that one element of insecurity in voluntary transactions has been successful contained. That is the first point I want to get across.

The second point is that government gets involved not only in defining the money supply, but also in setting the general interest rates banks can borrow. We know basically that the real rate of interest is somewhere around two, maybe three percent for risk-free investment. But when you have the federal funds rate going down to under one or one-and-a-half percent, what you essentially do is inject too much money into the system because you're not charging people the full amount of the money they have acquired. That means that they're going to acquire too much of the new money to purchase durable assets—call them homes—which are secured by mortgages obtained at these very cheap and easy rates. There's only so long you, the government, can continue to prime the pump by putting all this extra money into the system. The more that is done, the more you run a very serious inflation risk.

Yet the moment you, as government, cut back on the money supply, the refinancing options given to people who initially borrowed beyond their means with short-term paper, the standard pattern, are much more limited. They are now going to refinance at a higher rate, which will lead to additional defaults. At the same time, and this is synergistic, we had a very determined group on the liberal side in the Senate and House (Barney Frank, I think, is the chief culprit) trying to sponsor subsidized mortgages through Fannie Mae and Freddie Mac. These politicians encouraged people to buy a home, by way of a very small down payment and low interest rates. But this strategy was not sustainable at its inception, and is not going to become sustainable any time soon. Pursuing this ideal is just asking for trouble.

Now, how will private enterprise respond to all this? This is something I think libertarians will understand very well, which is that any time you have a government subsidy, private markets will respond rationally. They will aggravate and expand and magnify the error. That is the danger. You go back to this basic concept of self-interest. When you're dealing with anonymous financial transactions, you don't worry about the natural love and affection everybody has for his or her dog; these things just don't matter if self-interest applies to public financial signals.

In effect, we are now telling somebody at a bank that he has to lend this money to somebody to collect fees. Don't worry about the credit-worthiness of the borrower, you can lend against the government guarantee or the government obligation of repurchase. The moment you create this situation, we have created a wealth destruction mechanism of unparalleled significance. Somebody makes a loan on a property, and the day the paper comes back into his hand, its market value is 80 cents; the lending system so carefully nurtured has managed to lose 20 percent in one day. No matter—you can now sell off the dubious paper to a government agency or somebody else who has a government guarantee, who will receive a hundred cents on the dollar. At that point, people will lend against the guarantee or the repurchase obligation; they will not lend (because they don't have to lend) against the security of property. All the restraints that you would have placed on private parties in a market of scarcity are no longer in play.

We know what happens with bubbles. The first guy ventures into a risky market, and it works out fine. Here the government says, "Well, let's have another good idea by extending a good idea to the next group of potential borrowers." Everybody thinks the functions are linear; you can increase lending activity a little bit more and everything will get a little bit better; nothing will ever flip over on you and kill you. So we accelerate the process and, sure enough, we come to the end game. Somebody cannot resell or refinance, and the whole house of cards comes tumbling down because the salad days of easy-money are over.

The government guarantees are involved, but at the same time these guarantees now enable and help to prosper another kind of market of equal importance, the so-called securitization market. Now, most of you probably have not heard of securitization until recently, and some of you may not have the slightest idea of what the whole project entails, but essentially securitization was meant to avoid the kind of serious dislocations we had in the mortgage markets during the 1980s, which started early in the decade and blew up in the Savings & Loan crisis.

Quite simply, the securitization practice runs like this: if a bank originates a bunch of loans which pools in its bank portfolio, the bank takes a risk. Thus the bank that does not diversify is at risk if there is some local blip in the economy—Lockheed closes in Los Angeles or whatever. Now the mortgage risks are (imperfectly) correlated, so that all of the properties in that particular area are going to suffer in sync some kind of financial decline. So if you're a lender on those particular mortgages, without diversification in your portfolio, you will suffer very badly too, and your whole bank may then be at risk. Banks quickly learned that lesson. The cure they discovered had them diffuse their mortgage paper into a larger market, where it can be bundled up with loans that were originated in other areas, so that the bad luck you have in California can, with respect to the pool, be offset by the good luck in Arizona. Diversification was thought to be a powerful way to handle that problem, and securitization was one step in that larger process.

Once you get these bundles, however, the question is, how do you sell them out to the market? People realized that there were gains to be made from this trade by taking these mortgages and dividing them into tranches. This way, some people would be very secure, because they would get the first dollars coming into the pool, while other people would be in a much riskier position, essentially bearing the brunt of the first round of defaults, while others still got paid in full.

All of these complex divisions were made possible by modern computer programs capable of following, marking, and tracing the flow of these dollars, so that no matter where the money came in, it could be directed to the right parties. The securitization practice led to a strong amount of standardization with respect to mortgages, because the only way to bundle mortgages was to be sure that they all had the same basic legal attributes.

But here, again, is another version of the point I made before—diversification is a much more complicated concept than people once thought, for it turns out that certain strategies that allow you to diversify against some risks in fact make it impossible for you to diversify against others, and indeed, create a greater set of problems when risks actually correlate. So what happens is, when you start to securitize these mortgage instruments, the local variations in underlying property values are no longer able to bring a bank down, but any kind of national policy you have which impacts all of these securitized packages of mortgages simultaneously has the rare capability of bringing the whole edifice down. Sometimes private markets are not very good at anticipating regulation that will impact them.

Whether you want to call this tendency a failure of the market or a failure of federal regulation is that terminological point that has a lot of ideological baggage. But at this point I am more interested in understanding the situation descriptively, before making a normative judgment as to who the "culprit" was in this particular case. It is an effort to secure transparency on these credit issues. After parties create one securitized interest it becomes the basis for further transactions, as people can buy against them or borrow against them, or use them as security for various kinds of loans. One of the great geniuses of our market system is that anything that you buy you can resell. But as the process starts to evolve, private parties enter into certain, very complicated transactions—credit default swaps, for example, which are essentially contracts betting on the soundness of the other side's portfolio. In order for those contracts to be accurately priced, both parties have to be able to price their components. Yet in the mortgage market, these are long-term assets broken up into short-term pieces, and the real fluctuation in their value is a function not only of local conditions but of government regulation.

The government regulation that makes a difference in this case, which also helps explain the problem, is an obscure set of rules invoked both in loan covenants and by the SEC, called the mark-to-market phenomenon. This was the accounting norm that created immense dislocations in the late 1980s in the Savings & Loan business, and it has come back in the current malaise. As with many forms of public regulation, this approach has essentially been defended on the grounds that it increases transparency by forcing people to make clear what their portfolios were worth, even if they had not made the sale of any of its essential components.

If you own a capital asset on a particular book for which you pay $100, and the asset now shows $50 of appreciation, how do you treat this move on your balance sheet for tax and regulatory purposes? Do you force somebody to recognize the gain on the $50 without the asset being sold, or do you allow them to carry it at book value and make no changes? For the most part, in a tax situation, we allow the regulation of the taxation of the gain to be deferred until the holder has the realization of that debt as the sale of property in question. You get a book worth $150, subtract the original cost, subject to a certain number of adjustments, and find your gain or loss.

But in many cases, particularly when you're dealing with loan portfolios, this kind of deferment of the reevaluation of the asset is not going to work if the amount of money in your bank has to be determined in order to figure out whether you need to add reserve requirements or to meet the requirements in loan covenants. So you need to worry about some mechanism for intermediately undertaking the needed valuation. Mark-to-market starts to apply then, and again, the lesson is that if an individual firm goes bankrupt, any technique that works fairly well for uncorrelated transactions, which implies a relatively low level of failure in practice, may work quite horribly when it turns out that there is a positive correlation between the various events. Thus, genuine cascades take place and bring the whole system down, which is essentially what happened in some of the recent financial dislocations, such as Bear Stearns.

As one of my students at NYU reminded me, every one of the investment banks that failed on Wall Street was cash-flow positive at the time they were going down, which meant they were taking in more money than they were paying out, with respect to their portfolios. Stated otherwise, they were able to meet their obligations in the short run. This is not normally regarded as a sign of terrible trouble, because you have no observable behavior that announces that something may be wrong with the system. But the moment you have mark-to-market rules, you are no longer trying to evaluate the company by seeing what flows in and what flows out, figuring out the difference, and worrying about whether that positive or negative flow will last over the long run.

What somebody is requiring you to do is take one of these assets in a mark-to-market; that is, you can mark it one of two ways. If you mark up the asset, say because of an interest rate decline, the asset is worth little more than you thought, which is fine—nobody is going to go bankrupt by being told by the government that they have to declare themselves rich. In fact, with mark-to-market, under those circumstances, the use of the perceived value of the underlying assets does have a dark side because it paves the way for greater amounts in lending activity as the banks can increase their reserves without taking in new capital. On the upside, therefore, mark-to-market is a kind of stimulus.

But going into the downside is not symmetrical, because what happens is if somebody looks at this portfolio and divines under circumstances that we really don't understand that loan which you thought was worth $100 is now worth only $75. It is not just one loan the observer has wiped out, but the whole portfolio of loans that shares key common characteristics. They're saying, now, "Congratulations, you think you're making money, but if you closely look at the underlying assets, your liabilities exceed your assets." And so you are insolvent or nearly so. And the only way you can bulk up is to dump some of these uncertain securities, get cash—whatever that is—in order to build up the reserve requirements so that you can continue to operate.

But now remember, you are in an area of business in which the value of everything is positively correlated with the value of everything else, and the moment you sell your stuff, your very act of selling puts any additional pressure on the market. So

your portfolio may have been valued at 75 cents on the dollar, but the moment you start selling, that goes down to 70 because you've created this overhang on the market. Well, that's great. Then you look at bank number two, which was solvent at a valuation of 75, but for whom warning bells start to ring when its portfolio now has to be revalued at 70 cents on the dollar. One distress sale thus leads to another. Potential buyers see the second stage so that they don't bid in at the first. Owing to the correlated risks, what the mark-to-market dynamic generates is an absolutely perfect cascade.

This set of events leads to a very serious problem. You start throwing people over the cliff by marking to a market which changes in consequence of the rule of valuation under which it works. It creates, as it were, an economic kind of Heisenberg uncertainty principle with a vengeance. The mere effort to measure your level of insolvency aggravates the solvency beyond all reason with respect to original portfolios. This scenario, if correct, is not a laughing matter.

And then suddenly somebody comes up to you and says, well, what's the alternative? There's the rub. It's not so easy to figure out what the alternative valuation mechanism is to a mark-to-market system. Note that if you don't do any kind of adjusting to the market, the uncertainty about the relationship between inherited or book values six months ago and the current value of the portfolio will still create fresh difficulties. That is, the fragmentation of the interest of the system of securitization means that transparency is harder to achieve. Because there are so many part-owners, even if the various interest holders in the portfolio figured out that they had to make some key readjustments, it would very difficult for them to work a renegotiation that meets their needs.

So what happened, I think, is that the private market essentially overestimated its ability to deal with these risks. Thus it could have underestimated its own need for margin because it did not take into account the destabilization that mark-to-market created, either on the contract or government side. My own sense, and I'd like to speak to some bankers who may be able help me on this, is that if in fact we did not have a mark-to-market system, there would have emerged a voluntary market of discrete intermediaries, clearinghouse types or something of the sort, who would get this information, share with those people who needed to know in order to make the transactions workable. I suspect that some of the market makers would try to treat their data sets as a proprietary trade secret that they would sell off in competition in order to introduce some transparency that could lubricate transactions. That's my sense as to what might have happened, which would, of course, have been a much better result than the one that we have here. But it takes more detailed industry knowledge than I possess to be sure.

So now you're trying to figure out why it is that the libertarian principle is not as great as we might want. I think there are two explanations. One is that it's quite clear that herd behavior was observed in these particular cases, creating systematic externalities that engulfed everybody else. If you—if anyone—could figure out a way to stop that behavior with basic improvements across the board, no libertarian wants (or at least should want) to take the position that we are in favor of suicide pacts. I don't think that any libertarian, however extreme, would say, "You want to have writing requirements for contracts under the statute of frauds? That's a form of government regulation, it counts as a restriction on freedom of contract, so off with your head. If they want to have oral agreements, let them do it." Try telling that to the real estate business; they will kill you because high value, long duration transactions can't run on oral evidence and needs written evidence which is easy to supply given the typical transactional time frame. Essentially, what happens in these situations is that the government role has long been properly understood as a means to stabilize the security of transactions by making it easy to sort out transactions at the backend should any dispute arise in the interim.

If you can figure out a way to achieve that set of favorable in these treacherous mortgage markets, by all means be my guest and try to do it. Here, the government came up with two possibilities for handling the situation. Neither of them is crazy and both of them, I think, are consistent with a small government approach. One of them is for some government agency to buy the worst paper. That step takes these assets out of the bank so that its balance sheets are restored by getting rid of what we now call toxic assets. This operation is not easy to do, because the valuation remains subjective, and no one wants to treat them as having a zero value just because they are in government hands.

On the other hand, you don't want the government to pay the banks an enormous premium. The original purpose of the bailout was quite simply this: We, Treasury, will take some of these things; we will pay you more than you get on mark-to-market, because we think the discounted value of the future cash flows is worth more than that present exchange value of the asset, and believe good empirical evidence confirms that it is true. By setting some intermediate number, the hope is that just taking bad assets out of private hands and putting them in government hands will, at least in the short run, create a mechanism that will end the downward spiral of for-sale signs that have so disrupted the market,

The practice doesn't have any multiplier effect, however, in the sense that the nation still got this stuff around. The practice doesn't get rid of any liquidity crisis that the banks have to face, and so the Europeans first, and then later even the United States, decided to substantially inject some money into the individual banks to offset the loss of capitalization. That last step doesn't require anyone to make valuations of individual assets, toxic or otherwise, but it does require the government agents to make a valuation of what this particular share of the enterprise is worth so as to keep the transaction from giving an undeserved subsidy to the banks, or, conversely, taking over part of their portfolio.

In order for this injection of capital to work, the next step is to decide what form the government holdings will take? Is it going to be simply common stock or preferred stock? Some kind of voting preferred, nonvoting preferred, convertible preferred? Anybody who's done corporate finance knows that the number of ways in which you can divide a given pool of assets, putting share and debt claims on them, is potentially infinite. It actually takes some real technical expertise to figure out the optimal

capital structure. So now you see why bank protection always leaves everyone between a rock and a hard place. Let the government buy these assets up, and it faces valuation problems that won't quit, and for all that risk the positive effects are limited. If the government makes cash injections, the parties must answer all the business questions for which we don't have good answers: how much goes in, who gets it, and what's the form of the holdings that take place. All one can say about this venture is that doing something is likely to prove better than doing nothing. But don't hold your breath.

Now, what does the libertarian have to say? I'm going to end with two brief observations so that Steve can give some comments. First, what you learn most from this sort of situation is to prize the "never-again" maxim. Once you see the hell that is created with cheap money and subsidized mortgages, it is not beyond the capacity of government, even in a Democratic administration, to say we're just not going to go down this path ever again. But if we don't understand the origins of this stuff, we will go down this path again, so right now you have calls for additional stimulus packages, which are basically as useful to the market as stock dividends are in ordinary corporate transactions. The process of simple cash transfers creates uncertainty without generating any wealth. If Congress has not learned this brute fact, fear its future actions.

The second thing to understand about these political actors is that they cannot resist making the bailout an opportunity to achieve dubious collateral objectives. If you look at the bailout the House voted down Monday, September 29, it was about four or five pages. By the time it passed on Friday, October 3, it was 500 pages, 490 of which had nothing to do with the bailout as best one can tell. What happened was every Congressman came up and said, "Look, I will vote for the bailout if you'll do the following for my favorite project." We started sinking the effectiveness of the bailout by tying it into everything else. My favorite illustration of this is that these Solons managed to create mental health parity in health insurance markets via the Wellstone Act by tying them to the bailout bill. "Parity" means that anybody who wants to issue insurance against physical injuries now has to offer it for mental health conditions as well.

Anybody who's ever been in the health-care business understands that these are two different risks to insure. All this initiative is likely to do is create more un-insurance and make it virtually foreordained that the Obama health care campaign promise— "If you like what you have, keep it"—false. That happy scenario cannot be true because the use of mandates has already changed the older plan that employees had by larding on another mandate. So in an effort to create a bailout, we now engage in a systematic collective action of wealth destruction by interfering with markets in insurance, where they actually work pretty well and don't have any of the coordination problems we face in bankruptcy.

This set of problems is very serious. Essentially, our nation has gotten itself into a collective frame of mind where the bailout is enigmatic of a zillion other so-called market failures. Once we conclude that it is legitimate to regulate bailout, we now say it is legitimate to regulate anything we call a market failure—defined as a situation where the price at which good is offered in a competitive market exceeds the amount some people are able to pay for it. Thus we conclude that all competitive markets now have systematic failures.

So what is it we have to do? We have to learn how to focus. We have to recognize that the monetary system, the price system, the subsidy system, and so forth, are in fact government-created public goods which require government regulation. But the rest of our economic activity is something that can work if we want to let it. It covers the type of activities we don't want to regulate, or, if we think we want to do it, we have a full and complete debate that addresses these issues on their own merits, outside the bailout environment. These public choice dynamics we face will not go way. The pathology is hard to combat and it is an open question whether we will pile so much regulation onto this particular social raft to sink the entire operation, as opposed to simplifying the burdens on a few financial institutions. Think back to the good old days where all you worried about was Bear Stearns.

Thank you.

Steve Thel[*]: Thanks Richard. So, I'm billed as the Communist today, in the flattering sort of way that "communist" has come to be used by conservatives lately. That is to say, I have some reasonable suggestions.

First, I find it embarrassing that part of the financial crisis is a cascade problem. There is a panic. If assets really are being sold for less than what they're worth, why isn't somebody stepping up to buy them? If it's mortgage paper, and only worth 70 cents on the dollar, why can't they sell it? Why aren't there people out there doing it?

I think we probably agree, and it seems that many people agree, that this is not working, and that we have to do something about it. What I want to ask, though, is what got us here? I am not confident that it was either government pressure to make home loans to people who couldn't afford them or mark-to-market accounting that was the trigger for this cascade. We can get the wrong prescription here.

So, the subprime mortgages, in part, were mortgages for poor people, but they were also mortgages for wealthy people who were buying million-dollar houses and people who couldn't prove their credit-worthiness. The government wasn't forcing anybody to process those loans; Fannie Mae and Freddie Mac were not really involved in those, and they were many of the failures. Rather, I think what you've got is a set of mortgages in which the bank was long on real estate. And so long as real estate went up, everything worked. The borrower could pay his interest for two years, refinance as prices had risen, take down a lot of money and shift away from a very risky mortgage to a standard mortgage. Everything worked fine while prices were going up, and surely the banks knew that. The banks knew that this would work while prices were going up and would fail to work if prices stabilized, let alone fell.

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The people who were buying these loans knew the same thing. People who put these things into portfolios and invested in those portfolios were fairly clear that subprime loans depended on prices going up. If they failed to go up, you would have problems. But oftentimes, banks and others make loans that aren't going to be paid off, and the failure of the Internet bubble or solar power or anything else doesn't lead to this incredible contraction of the market.

So what about this failure is different and leads to a contraction of lending markets? Is it mark-to-market? If mark-to-market accounting for financial firms doesn't really reflect what they're worth, shouldn't people who are investing or lending in them or borrowing from them or managing them simply ignore it? If the accounting is misleading, if it shows their assets are worth very little, just ignore it. You know in fact that they are worth more. That doesn't work for regulation.

If a regulator says you can make loans if your capital is too low because of mark-to-market, that's a problem, but a lot of people who are having problems now aren't in that situation. These lenders are not prohibited from making loans because their capital is inadequate, because it's artificially depressed by mark-to-market. They're not making loans because they don't want to make loans. People simply don't know the situation of their counterparts. And so what I want to offer is something that Richard said also, that is the incredible complexity of the situation and the lack of transparency. Securitization, which allows for the spreading of loans, also creates instruments that nobody can look through. If you take a set of loans and divide them into a portfolio, putting them in your second portfolio and a third, and on and on, at some point it is literally impossible for anybody to figure out what you own and how risky it is.

So then, once the risk is in the system, and market prices for houses are falling, and other things, is it possible for anybody who owns those assets to know how much they're going to get in the end? This is not some mark-to-market problem; it is just impossible because of the opaque character of the assets' worth. At that point, lenders don't know whether they can pay. That turns out to be a problem across the board. And so what I wonder is whether the free market created, as you put it, incredibly complicated, opaque instruments that destroy transparency, and that, once they became widespread, made it very difficult for people to work among themselves.

If that is the problem, the easiest way to prevent it in the future is to insist on a great deal more transparency. We would probably evolve towards a clearinghouse system, and that will happen voluntarily. If it doesn't, I have no problem with the government pushing them towards that transparency, because apparently the unregulated market can't do everything perfectly. We certainly shouldn't overregulate, but transparency is a problem. We shouldn't count on transparency as a naturally arising attribute in these markets. And so, Richard agrees that transparency may be the solution, but I ask whether the government should have been pressing for transparency earlier.

I also want to congratulate him on noting that the Democrats presented a four-page proposal to save the banks, and that, in order to bring those Republicans on, it had to have 500 more pages of buying dresses for the vice president.

So I guess what I want to ask is, have we learned from this that markets can't be counted upon? That it is reasonable to have government regulation for transparency? I think we are both in favor of government relations for avoiding fraud. Is this some sort of kicker on fraud or transparency? Other than that, I agree entirely.

Epstein: Can I make a couple of responses? Yes, the Communist and the Libertarian now come together. But there are two problems I have with Steve's approach, and they're not meant as criticisms, just evidence on how difficult this whole project is. The first point is, once we say that we are in favor of regulation, pray tell, what does that regulation look like? What you have to understand about the derivative market is that these things are written or oral contracts, but they have no particular physical location which could serve as the appropriate forum for regulation. And so, parties could write a derivative contract on an American mortgage in Ireland with a Greek counterparty. Unfortunately, if the government regulates so much domestically so that the market goes offshore, we will have serious problems, which means that global solutions become more desirable. But again, there is no free lunch. At this point you are again subject to the Christmas tree effect, because you won't get sensible global regulations unless you give subsidies to poor people from different nations, and then you're off to the races again with the possible scope and size of the transfer programs,

So it's not as though, once in favor of regulation, you know what to do. My sense is, and I think Steve would agree with this, the best thing you—and it is not clear who that you is—can do is to nudge people in the direction of private clearinghouses, because those intangible assets can be extraterritorial in a way in which government regulation cannot be. Essentially, a clearinghouse is a person in the middle who is sure that these changes balance out, and who thus takes some residual risk if he can't clear the market on both sides. That's the way I understand it. And it may well be that the ability to get the third-generation derivatives makes the prospects for sound intermediation much worse.

The second point is a modest disagreement. I think that Steve is quite right that the subprime market was one and all into us. But it's wrong to assume that, because you have some of these loans in an unregulated market and some in a regulated market, they should be treated independently for regulatory or contract purposes. Once parties start bundling assets, the level of transparency necessarily goes down. The moment you get the forced sales on one side of the market, there are going to be ripple effects on the other side of the market, which will exaggerate the whole situation.

So it's not as though there is a direct or sole or exclusive cause. I think the general loss of market confidence through a series of uninformed consumers will make it hard to segregate a response to different market segments. I predict that we shall see a general decline, simply because if you don't have very clear information as to what is in each bundle, it is hard to take any prophylactic steps to avoid the flight to the ostensible certainty of cash. Faced with these risks, humility goes a long way.

So to repeat, on the government side, if you avoid the subsidies, you reduce the probability of a recurrence. This is not to say that federal regulation is the sole cause—it isn't—but it's not to say, on the other hand, that it's completely benign. What you want to do is become a kind of classical liberal, rather than a hard-line libertarian.

Endnotes

1 *See* Richard A. Epstein, *Strident and Wrong*, Oct. 28, 2008 http://www.forbes.com/opinions/2008/10/27/slate-libertarian-weisberg-oped-cx_re_1028epstein.html, commenting on Jacob Weisberg, *The End of Libertarianism, The Financial Collapse Proves that its Ideology Makes No Sense*, Slate, Oct. 18, 2008, http://www.slate.com/id/2202489/

2 Milton Friedman & Anna Jacobson Schwartz, A Monetary History of the United States, 1867-1960 (1963).

Conservation without Regulation: Property-Based Environmental Protection

University of Cincinnati, March 19, 2009

Jonathan H. Adler[*]**:** It's a pleasure to be here on this fine afternoon. What I want to do is briefly sketch why we should think about protecting the environment in a radically different way than we currently do.

The way we have gone about protecting the environment has not been particularly effective, and one reason for that is because it doesn't pay enough heed to certain traditions which have served our country quite well, particularly the institution of property rights. I'm going to start with the Endangered Species Act (ESA), because it is, I think, one of the most popular environmental laws, but I think one that has had the most startling results.

In the 35 years since the ESA was enacted, we have listed over 1,800 species as endangered or threatened. The goal of the Act, according to its own terms, is to recover species that are defined as endangered, to get them to the point that they no longer need to be on the list. Being on the list is kind of like being in the emergency room. It means the species is in trouble; it means it might not survive. We want it out of the emergency room. We want species populations to be healthy so they don't need this extraordinary protection.

Well, in 35 years 46 species have been taken off the list, and that was as of a week and a half ago—46 out of over 1,800. That's a pretty small number, but it's actually worse than that, because if you go to the Fish & Wildlife Service website and look at species delistings, and you look at the reasons for each one that has been taken off the list, you see that 26 of those 46 were taken off the list either because they went extinct—clearly not a success—or because there were data errors—we miscounted how many there were,we thought something was distinct taxonomically, we thought it was a distinct population segment, or something like that, but we listed it in good faith and we just made a mistake. We didn't know as much as we thought we knew about the species.

So, there are 20 species that have been taken off the list because they're actually doing better. But the story actually might be worse than that when you look at those 20. Species like the peregrine falcon and the brown pelican, for instance, are certainly doing better, as are quite a few other birds that were listed as endangered. Yet they are doing better because we banned DDT in 1972, the year before the ESA was enacted. So while they are doing better, it is hard to credit the ESA with their success.

We can identify several other species that used to be listed which are now doing better, such as species of kangaroo in Australia, but they're not here in the U.S. The ESA, in particular the regulatory provisions which I will focus on, can't really claim any credit for that. There are small species of deer that are doing better, too, but largely because of predator control. The species in this category came back because we finally started doing some very basic things in terms of habitat management, largely on federal land. But not one of the species that has been delisted was recovered by the primary regulatory provisions of the Act, the provisions that restrict private land use in order to preserve the habitat of endangered species. Not one recovery in 35 years can be attributed to that portion of the Act.

That's not just an isolated statistic. There is actually a causal relationship. The way we try to protect the species, the premises upon which the law rests, prevents our saving species on private land. That should be particularly concerning to us, because the majority of species that are listed rely upon private land for some or all of their habitat. If we don't save them on private land, we probably won't save them. So how the ESA works on private land is of essential importance.

Why doesn't it work on private land? The problem is the incentives it does and does not create for land owners, as Sam Hamilton noted in the 1990s. Hamilton was the official monitoring service administrator for the State of Texas. Texas has very little federal land and very little government land at all—almost all of Texas is private land, which is relatively unique for states west of the Mississippi. So unlike some other western states, there is really no way to save species other than on private land because there is no land other than the private land.

As Hamilton explained, if I were to find rare metal on my property, its value goes up. If a rare bird occupies the land, its value disappears. When you find something, like a valuable mineral, you can use it, you can sell it. It's worth a lot of money. Your land value goes up. In Texas, you could find oil. But if a black-capped Vireo or a golden-cheeked Warbler comes to your land, all sorts of restrictions follow, your ability to sell that land declines, your ability to use that land declines, and the value of that land does as well. So, we're penalizing landowners who have, deliberately or not, managed their land in a way to make it attractive to endangered species.

Larry McKinney, who was the Director of Resource Protection for the Texas Department of Parks and Wildlife, also said in the 1990s that while he didn't have any evidence to prove it, he thought these incentives were so great that at least for the species he was concerned about—the black-capped Vireo and golden-cheeked warbler, which are a big focus in Texas, two of its listed endangered species—that he thought more habitat had been lost because of these incentives than if they had never been listed at all.

Since these statements were made, we actually now have some empirical evidence. There was a period of time where all the accounts were anecdotal. Individuals would recount the particularly egregious case of a single land owner. There's a man in North Carolina named Ben Cone who has been much written

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about. He managed his land very successfully for habitat for various types of wildlife. A lot of red-cockaded woodpeckers showed up. His ability to maintain different practices on his land was curtailed. He clear-cut most of the remaining portions of his land to prevent them from being regulated. And then it became an issue at a Senate hearing, and he was given a special permit that was not quite illegal but was pretty clearly thrown at him to make him shut up and go away.

We have other anecdotal accounts. In the *Federal Register* when the Fish & Wildlife Service would refuse to designate critical habitat, sometimes we'd have these oblique lines about how we don't do it because designating critical habitat might cause stress to that habitat. Everyone knew that meant that in the areas where people were afraid of these effects, people will basically go out and prevent the creation of (or actively destroy) species habitat.

But we now have empirical evidence. There are four empirical studies now. Two of them focus on the red-cockaded woodpecker. One has been published in the *Journal of Law and Economics,* the other one was published in *Economic Inquiry*; one by Leuck and Michael, the other by Daowei Zhang. Both, using different methodologies, found the same thing—that landowners systematically engage in preemptive habitat destruction to avoid being regulated due to the red-cockaded woodpecker. Red-cockaded woodpeckers are a cavity nesting species. They basically need older trees, in which they can build holes to nest in. Whether you're an industrial timber owner or a small owner with trees on your land, if you know the red-cockaded woodpecker is on your land, you know to cut now. It's suboptimal from an economic standpoint, but the trees are too young for woodpeckers. If you leave them standing, they may become infested—a terrible word to use when we're talking about creating habitat for endangered species, but that's how it's viewed by people that experience and suffer these consequences. Rather than risk the loss of the value of the standing timber, they engage in preemptive action; the two studies found this occurred systematically. The age at which timber is harvested correlated with the presence or proximity of the red-cockaded woodpeckers.

Another study in *Conservation Biology* about the Preble's Meadow jumping mouse found that for every landowner that learned of its endangerment and would take measures to protect it, there was another in its habitat who said he wouldn't do a thing to help. Those who wanted to help, presumably did so because of the knowledge that a species needed help. The ones who say they're unwilling or less likely to do something to help can only have one reason (unless they have some bizarre animus against the Preble's Meadow jumping mouse). It's because they're afraid of the regulations. The same study shows that a majority of landowners would no longer allow biologists on their land if it had been inhabited. So not only do we lose habitat, but we lose research as well because landowners are afraid biologists will find something. And when they find something, we bear economic costs.

Another study out of the University of Chicago led by John List also found the same thing: Deliberate habitat destruction in Arizona due to the presence of a species of pygmy owl. So every empirical study which has looked at this problem found the same thing. These incentives are not just some economic theory. It isn't just anecdotal. We're seeing that over time we lose the most important thing for endangered species—habitat—because of the incentives created by the way we regulate.

Now, there are alternative ways of thinking about species conservation. Let's turn away from the United States for a moment to talk about how they protect species in places that don't have the resources we have here. From the mid-1970s through the mid-1990s, there was a kind of controlled experiment going on in sub-Saharan Africa over how to save elephants, with countries, very similar in many ways, adopting different types of policies. We had countries like Kenya, which for African countries with large elephant populations, was relatively wealthy during that period, getting a lot of support from countries like the United States to keep its significant wildlife populations alive. Kenya's strategy, like ours, was to do everything it could to prevent people from harming the remaining elephants. Other countries, bizarrely enough Zimbabwe—not known as a particularly property-friendly country even then—said we're going to take a different approach. We're going to see if people that actually live in the parts of the country where the elephants are don't have a positive incentive or reason for keeping the elephants there. They were faced with a choice of using their land for agriculture, for grazing, or leaving it to the elephants. On federal land, the elephants would have had no value.

Now we in this country see elephants as these majestic creatures—and they are fascinating, wonderful creatures. But if they're competing with you for land, for water, and they go on rampages that trample your crops, trample your family, you may not feel the same way about them.

And so, Zimbabwe said, we're going to create the opportunity for individuals and communities to own elephants. Large landowners were allowed to own the wildlife on their land; communities were given something called the "appropriate authority," where essentially they owned the elephants communally, and they could decide what would happen to those elephants. That would mean that they could sell hunts if they chose. Hunts for hide, for meat, for ivory—when ivory could still be sold on the open market. And it's interesting what happened. Zimbabwe did not have the relative wealth of Kenya, it did not have the foreign support of the Kenyans. It had nothing approaching Kenya's civil service, which wouldn't meet American standards but was comparatively more advanced.

What happened? Kenya's elephant population from 1985 to 1995 went from over 100,000 to 26,000 elephants. Prohibiting hunting, prohibiting use of elephants, removing people from elephant areas, trying to prevent the sort of problems that lead to habitat loss or devaluation, all of this was tried and still the elephant populations plummeted. Over this same period, Zimbabwe's elephant population rose from 45,000 to 65,000. Zimbabwe changed the institutional arrangements so that the people were given an incentive for there to be more elephants rather than less—unlike what we have done with the ESA here.

But there is a statistic that is more significant than numbers, because people like ivory, and they may have only wanted elephant skin boots or something. What about all the other species? Charismatic mega-fauna may be what attracts us, but those aren't the bulk of the species. Well, the most interesting thing that happened in Zimbabwe over that period is that the proportion of land suitable as elephant habitat almost doubled. All the other species that rely upon the same ecosystem as the elephants benefited tremendously, without all the resources necessary to create massive national parks and grand regulatory structures. The broader environmental benefits are ultimately what we're concerned about, not just a handful of pretty species, and the habitat increased dramatically.

Why? Well, because land was valuable now for something other than grazing cattle or growing crops. In fact, private ranches were removing their cattle, letting cropland go back to native vegetation, and ranchers began coming up with agreements to take down the fences between their lands to create effectively large national parks so that the species could roam. It was incredibly successful. And there were countries in the southern part of Africa that adopted similar policies and met similar results. Zimbabwe is particularly striking both because of how far they went and because of all the reasons we would think Zimbabwe would fail.

The lesson here is that institutions matter. When you look around the world at those environmental resources that are in the worst shape—tropical forests, open access fisheries, water in the southwestern United States and on certain continents, non-domesticated wildlife in the United States—these are the sort of species we're trying to protect with the ESA—we see resources in trouble. All of these are areas in which basic property-bsed institutions are nonexistent or poorly protected or poorly maintained or, in the case of the endangered species, severely destructive.

But if we can look at other resources, if we look at temperate forests in the United States, were there has been significant net forest growth over the last hundred years, look at fisheries managed through property rights like the individual transferable quotas (ITQs) in Iceland or New Zealand, or even in the handful of ITQs we have in North America even mineral resources, which are purely privately owned, or domesticated wildlife or exotic wildlife in the United States that can be owned, we see resources not dwindling but expanding.

There are more scimitar-horned Oryx in Texas, roaming private land, than there are in their native range in Africa. Not only are you not penalized for having them, they can also be reduced to ownership without actually having to put them in a cage. This is important because I think most of us don't think that putting animals in cages is really saving them. At least I don't feel that way. So we see a pattern. The institutions matter. Where we've found a way to extend property institutions through environmental resources, they did better. Now it doesn't mean it's always easy to do, but we do see some broad lessons that, when things are managed politically, they tend to do much worse than when they are managed through property institutions.

There are couple other things I just want to note in terms of institutions. We can think about incentives that are created for efficiency and innovation. One of the most significant environmental success stories of the 20th century in the United States has been our ability not having to dig up massive amounts of land or construct mines and smelters for copper to meet our communications needs. What did we replace it with? Well, practically the most abundant resource on the face of the earth: silica (sand).

Fiber optics aren't only incredibly beneficial economically, they're an unbelievable benefit environmentally, driven by the economic incentives created by proper institutions as realized through our market institutions. No one thought, ooh, I'm going to do this, and think of all the landscapes I'm going to save because we're not going to have to have copper mines and smelters anymore. Think of the air quality benefits. No one was thinking about that, yet it happened.

Lynn Scarlett, until recently an Interior Department official, used to do a lot of work on solid waste issues. She's a relatively small, thin woman, and used to do these lectures where she would take a soda can and rip it in half. And for most folks in this room, that's probably not impressive. I mean, I know you can rip a soda can. But the idea of a small, thin woman picking up a soda can from 20 years ago and ripping it in half like it was nothing was crazy; now it's nothing. The amount of metal that goes into a can has been reduced that dramatically. That's a tremendous environmental benefit. We're talking about aluminum—tremendous benefits from energy use, in terms of the use of materials, again, driven merely by the fact that incentives are working in a positive direction.

Now there are other things we can talk about as well, because, obviously, it's not just about resource management. It's also about pollution. And certainly efficiency gains can reduce pollution but may not cause firms not to pollute at all. In the United States, we still rely primarily on a command-and-control model of pollution control. So for example, when it comes to water quality, what we care about is a company getting a permit, an NPDES permit, for what it's going to emit. Our goal is zero discharge. What matters in terms of whether you can be sued, whether you can be liable, whether you can be fined, is not whether or not you're harming the river, not whether or not you're killing the fish, not whether or not you're poisoning somebody, but whether or not you're in violating the terms of your permit. Some of you may have read the case *Friends of the Earth v. Laidlaw Environmental Services*. The Supreme Court said quite clearly both for standing purposes and purposes of the Clean Water Act that you don't need to harm the environment to harm the person. In that case, it turns out that when measurements were made upstream and downstream of the facility in question, despite the almost daily permit violations, they couldn't find a difference in water quality. Yet a company that's complying with its permits and causing harm may have no risk of jeopardy at all, certainly not statutorily; except maybe under the common law where it still operates.

Now, in much of England water rights are still protected through a more property-based system. There's an organization called the Anglers Cooperative Association. It's sort of like a

British environmental group, although instead of suing under citizen suit provisions and statutes and lobbying legislators, what it did was go to court to represent property owners (fishing clubs primarily) whose rights had been destroyed or devalued by upstream polluters, by upstream dams, and the like. It has been incredibly successful. Their causes of action are based not on whether your permit is written properly, but on whether harm has actually occurred. And the determination of whether a company has acted reasonably is ultimately based on the plaintiffs who hold the property rights. Not only has it been successful controlling pollution, but also, and more importantly, it spurred a lot of creative effort to figure out how to avoid these problems. What is it that the upstream entity is doing that is causing the problem? Let's not focus on some standard that applies to every company. Let's focus on what *this* company is doing that's causing this problem so we can solve that, and the fishing club, the rights owner, and the company can come to a deal.

If you read *Boomer v. Atlantic Cement*, there's a line in the majority opinion where the majority expresses shock—it is aghast really—that if they recognized a property rule defending Boomer, Boomer might sell, or that Boomer and Atlantic Cement might reach their own deal. I've never understood that part of *Boomer*. That would seem to me to be fine. If Atlantic Cement and Boomer can reach an understanding where either Atlantic Cement is compensating Boomer so that Boomer feels whole or Atlantic Cement can figure out what it needs to do to change its operations to actually meet Boomer's concerns, well, why shouldn't they? And if there are going to be lots of Boomers in the neighborhood, well then maybe Atlantic Cement is in the wrong place.

The point is not that we should go back to common law environmental protections and rely solely on that, but rather that we can understand the underlying principles that are focused on protecting property rights from infringement. You can imagine what those rights would look like were they embodied in a regulatory system that, for instance, focused on whether somebody upwind harmed somebody downwind. The Clean Air Act has been around for 38 years, and it wasn't until about ten years ago that we first started actually worrying about upwind states harming downwind states. To me, that would seem the thing we would want to focus on first. We knew that some local jurisdictions had actually been quite effective in dealing with the air pollution problems they were most concerned about when they didn't have to worry about upwind jurisdictions. They adopted smoke control ordinances and sulfur dioxide concentrations in the ambient air were actually declining prior to the enactment of the Clean Air Act of 1970.

This doesn't mean that federal law isn't necessary, but rather that we need to make it easier for communities and individuals to protect themselves from upwind sources and spend less time telling them how to run their own affairs. If we were to focus on common law protection of property rights and pollution control, we would be focusing on actual harm. We would recognize the context-specific nature of many environmental concerns. We would be willing to award injunctive relief. But we would also recognize that ultimately with a focus on property rights and concerns the ultimate decisions are made by those who bear the costs and reap the benefits of those decisions. This would be our goal, rather than a one-size-fits-all standard which is actually a one-size-fits-nobody standard for what is acceptable contamination.

Typically when we've had environmental problems, the argument has been that the problems derive from market failure. Markets do not account for all the externalities. Markets don't account for every potential external effect of every transaction. The traditional prescription, to have the government come in to "fix" the "externality," I reject for two reasons. First, it means the government has to do everything, because there is no transaction that doesn't have external effects. Some environmentalist orgainzation is upset when there are quick timber sales that are conducted to remove timber after a fire. Somebody from the Objectivism Center is going to be upset that there's not another big building being built. They have very radically different preferences, neither of which is accounted for in all sorts of decisions..

But the issue isn't market failure; it's a failure to have markets. We haven't thought seriously and creatively enough about how to extend the market institutions we have, and the property institutions on which they are based. We haven't thought seriously enough about how to extend them, to build upon their successes, to reinforce them where they don't work as well as they should. Instead we've tried to supplant them with a regulatory framework which doesn't serve us all that well.

So, thinking about where we go from here, I'd say first we should be doing no harm. Second, we need to look at the laundry list of things that governments at all levels, but particularly the federal government, have done over the years. That would be a massive start. Why was the federal government subsidizing the destruction of wetlands, subsidizing the slaughter of bison, subsidizing the slaughter of all sorts of species that are now listed as endangered, effectively exempting certain types of federal entities from sorts of pollution standards that apply to the rest of us? We should be trying to expand market institutions—property rights and voluntary exchange, protected by the rule of law—and we should try and build on common law principles, recognizing that the underlying principles are really what we're trying to replicate in environmental protection.

Decentralization may be a way to get some of the experimentation necessary to see how some of these things work, because it's not as if every regulation works the first time it's tried. We have to learn by doing. We're going to have to do that with other alternatives and approaches as well. But in all cases, we need to recognize the importance of institutions and incentives, which is something we have tended to ignore with our current environmental laws.

One cautionary note: my claim is not that if we just expand property rights, all environmental problems will go away and we would have Nirvana. Anyone that tells you their desired approach makes all problems go away is not being straight with you. There's no going back. We're not going back to the Garden of Eden. We're not going back to some place, if it ever existed, where human activity and human civilization did not have a

tremendous effect on the world around us. It does. What we have to do is figure out which institutional arrangements do a better job of managing those effects in a way that is acceptable to all, compatible with the other values that we have. From that standpoint, I think there's a strong case for greater reliance on property-based institutions.

Thank you for your time.

Joseph Tomain*: This is the first time I've had the chance to meet Professor Adler, but I know him by reputation. I also know that if anyone wishes to be a serious student of environmental law or a scholar in environmental law, they really have to read Jonathan's work, which is uniformly excellent.

Relative to a lot of what Professor Adler said and where he ended up, I concur—sort of. Part of what I get from Jonathan's remarks is that if one had a preference, one might say, gee, regulation is not generally a good idea. In fact, I've made that argument successfully in courts and before agencies. I've done it on behalf of developers, and I believed it then as now. I've also made the argument in courts on behalf of developers that regulation is good, that it has beneficial purposes. For me, it is not an either/or thing, and that's where Jonathan ended up. We certainly agree on that.

But I'm going to use his remarks as a point of departure to take shots at a couple of different targets. These are comments that were stimulated by Professor Adler, and they're not comments directed at his remarks. I have two points I want to make today. Point number one: beware of the tyranny of slogans, or never make policy by anecdote. The second point is that there is no such thing as a free lunch. A corollary to that remark is, without government, there are no markets; without government, there is no property. And so, the idea that the choice is between government regulation or a free market is impossible. Or to put it differently, it doesn't make any sense.

So let's go to the first point about the tyranny of slogans. The slogan I want to concentrate on is "property rights," and not the way Professor Adler used it but the way that it seems to come up in the popular literature. A few years ago I was asked to be on a panel that dealt with the *Kelo* decision while *Norwood* was in the Supreme Court. I hadn't taught property in a while, and I decided, well, I'd better do some research, so I figured I'd Google "property rights," which I did.

The first hit I got was an organization whose home page consisted of the following: a picture of the American flag, the Bible, and a gun. That was the property rights organization. Clearly, if you didn't believe in property rights, you were not patriotic. Clearly you're not God-fearing, and you are in danger of being assaulted without any protection by a gun. And so, this phrase, this slogan, "property rights," got me a little nervous because I realized that in the popular press it really was about a political agenda, and is not about policy, the way Professor Adler has been discussing it and the way I intend to discuss it. And it certainly wasn't about law the way either of us understand it. So this idea of property rights, I think you should be a little wary of.

In lots of instances, it's not that there is too much regulation, the problem is that there isn't enough regulation. Here I think I will definitely differ with Professor Adler, and we can both do this by way of anecdote. Growth management—do you remember that old idea?—it got no traction, or very little. It's a land-use concept, and it was designed intentionally in the late 1960s and early '70s to stop urban sprawl. That's what growth management was about. I was representing developers, so I was a big fan of it. I don't think it worked particularly well, but you know what? Today, we do have urban sprawl, and we have invested in infrastructure that is not efficient whatsoever. Maybe it was a good idea. It might have been. But I don't think we can throw it out as an idea that was stillborn.

In 1972, a group called the Club of Rome published a book called *The Limits to Growth*. At the time, it was seen as a hysterical book about what dire consequences are going to happen to the environment, and relatively well trashed. This was an important group of people, mostly based at MIT. Well, we're finding out that the predictions in the model they used 36, 37 years ago are more and more accurate and true, particularly relative to oil depletion and climate change.

Too little regulation, or too much? Over the last three-quarters of the century, we have built an electric grid in this country that was designed with a particular industrial model in mind. It worked very well for three-quarters of the last century, but it ends up serving fossil fuels, and it does not at all serve renewable resources well. So we may need a change, and a change will require serious regulation.

Another problem with regulation isn't so much its existence or its absence; it's the fact that often regulation is unenforceable. One wonders whether or not flood plain regulations would have reduced significant losses of land over the years. One wonders if mining regulations, if enforced, would have avoided the loss of life in Sago and Crandall Canyon. One wonders if the Surface Mining Reclamation Act, if enforced, would have protected streams and protected topsoil. One wonders whether or not the Clean Air Act, if enforced, would have reduced CO^2 emissions into the atmosphere.

These are examples, and you can't make policy by example, but I think you can use examples to start uncovering those policies that ought to be considered. That goes to the first point about property rights: the phrase "property rights" shouldn't be used as shorthand for doing nothing.

The second point I want to make is that there's no such thing as a free lunch; without government regulation, there are no markets and no property rights. Here's my very simple point—you can do this at home. Think of any rule of property, contracts or torts that you had in your first year and ask yourself the following question: What was the point of that rule? Or did it have no point? If you think about it, you will find that there are principles in the common law; it is trying to achieve something. A contract rule about compensation, for example, is designed to make somebody whole, so that they don't lose as a result of someone's action or breach of contract. The rule

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against perpetuities: What is the point of the rule? Is it not to make some property alienable at some point? Strict liability: What is the point of that rule? Is it not to reduce transaction costs in the case of injuries? There is an obvious policy point to the common law. We can debate whether every rule is about efficiency or not; twenty-five years ago, there was a substantial debate about that. But my point is somewhat different. The common law in and of itself is a regulatory regime. It's one of the options we have available in society to decide how we want to order our society. We can rely on common law rules, but they are not the only regulatory regimes that we can consider, but it is one. The beauty, for me, of the common law rules, sometimes referred to as the common law baseline, is that they really are the backbone of markets. Property laws and rules themselves define this thing called "property." Tort law protects property from damage, and contract law enables the transaction and a change of property. That's often what we mean by "the market," but it is one regulatory regime, and, as Jonathan alluded to in the next to the last slide, there are such things as market failures.

The question for me is what regulatory mechanism works best to achieve whatever end you wish to achieve? There are only two ends, I think, for government if we distill it down. We want a government that has rules that promote more benefits than costs; let's call that efficiency. We also want a government that has rules for the purpose of fairness. Now you can go to any political philosophy library in the world, and you will not find the ultimate definition of "fairness." You may not find in an economics library an ultimate definition of "efficiency." Both concepts are contestable. I get that. But for our purposes, you can reduce the purposes of government to these two general concepts of efficiency and fairness or efficiency and equity.

I would suggest that 99 times out of 100, there will be mixed reasons. A rule that allows an individual to sell his property to whomever he wants under any set of circumstances may maximize liberty and be efficient in that regard. It also will allow him to engage in racial discrimination. It may be efficient, but it may not be fair. A rule that allows someone to do whatever he wants with their property and keep it unkempt or even harmful to neighbors may be fair in terms of allowing maximum liberty to an individual, but it's hardly efficient. So we're going to mix those purposes often enough, and I think you should be aware that.

I'll end with the following point. I know nothing about grazing, but let's say that we want to protect grazing lands. It would seem to me that we could take two common law rules that we could play with—I'll use, for those of you that are not familiar with Calabresi and Melmed nomenclature—we can protect property through a property rule which allows one to get an injunction, or if your property is injured you can protect it with a liability rule and get damages. Those are two common law protections—protect rules through injunctions or damages.

So let's take what we normally refer to as "government regulation" and come up with two government regulation regimes. How about licenses? This is what the Bureau of Land Management does. You get a license and there are conditions on the license, and we can debate the conditions and mix and match those as well. But you can get a license, or you can use a standard. You can only graze so much, or for a certain period of time or up to a certain quality, often referred to as "command-and-control regulation." So we have four things we can do, two out of common law bucket, two out of the regulatory bucket. To me, it seems the issue is this: Which of those works best? Which of those works best to achieve the end we want? The question I think we have to engage is among these different regimes, common law and regulatory, we have a choice among property institutions or regulatory institutions. To me, that's the debate. I'm perfectly happy to go along with a system where property laws, as we commonly understand them under the common law, function. If they don't, however, government regulation is an alternative that has to be considered.

So, to conclude, beware of slogans like "property rights." Dig down, and find out what people mean by that. And secondly, recognize it's never an either/or choice. It's not about markets or government. These things are as mixed as could be, so it's always a question of how much effort or how intrusive the regulations are. It is not their presence or absence.

Thank you.

Administrative Law & Regulation

Regulatory Activity in the Bush Administration at the Stroke of Midnight

*By Susan E. Dudley**

One of the first acts of the Obama administration was a January 20 memorandum from White House Chief of Staff Rahm Emanuel to federal department heads aimed at stopping the midnight regulations of the outgoing Bush administration. The memo directed agencies not to send regulations to the Federal Register until they were approved by policy officials appointed by the new president, and to retrieve from the Federal Register all regulations not yet published.

This action was expected and appropriate. In 1993 and 2001 the incoming chiefs of staff for both Presidents Clinton and Bush issued similar memos upon taking office. These moves recognize that regulation is one of the most important ways the federal government sets policy and diverts private resources to achieve social goals; indeed, regulation is one of few areas of domestic policy that an incoming president can immediately control.

These memos also reflect an awareness of the historical tendency of outgoing administrations to increase regulatory activity in their final months. The midnight regulation phenomenon is measurable. Jay Cochran examined Federal Register data going back to FDR and found a statistically significant 17% increase in regulatory activity, on average, in a president's post-election quarter (November to January). President Clinton's post-election quarter output was more than 25% higher than during his non-election years.[1]

Bush's Chief of Staff Josh Bolten was also aware of the historical tendency of administrations to increase regulatory activity on their way out the door. In May 2009, he took the unprecedented step of issuing a memo to department and agency heads directing them to "continue to minimize costs and maximize benefits for each of their upcoming regulations, and … avoid issuing regulations that are unnecessary." In "an effort to complete Administration priorities in this final year while providing for an appropriately open and transparent process," he directed that "except in extraordinary circumstances, regulations to be finalized in this Administration should be proposed no later than June 1, 2008, and final regulations should be issued no later than November 1, 2008."

As a result of Bolten's preemptive action, Emanuel's memo applied to significantly fewer regulations than had Chief of Staff Andy Card's memo eight years earlier. On inauguration day in January 2001, there were 43 significant final regulations in the queue but not yet published in the Federal Register. In January 2009, there were only 4. During its last 3 weeks in office, when administrations have historically been rushing to issue final regulations, the Bush administration completed only 20 final regulations—less than one-third the 72 final regulations completed by the preceding administration during its final weeks.

Does this mean the Bolten memo served to break the historical pattern of midnight regulations? It did not. As I saw firsthand, the incentives for policy officials to put their stamp on policy by issuing regulations on their way out the door is simply too strong. Though regulations require enabling legislation, Congress generally grants departments and agencies broad authority, so the executive branch has considerable control over the details of policies developed through regulation. By the last few months of an administration, it is too late to expect significant legislation from Congress, so regulations are one of the few tools available to outgoing executive branch officials wishing to leave a legacy.

When President Bush appointed me as Administrator of the Office of Information and Regulatory Affairs (OIRA) in April 2007, I had studied the midnight regulation phenomenon and was fully aware that countering these powerful incentives would be a major challenge for my office during the final 22 months of the administration. Right away, I began meeting with each regulatory agency to go over their priorities and discuss the timeline needed to complete actions. Regulations cannot be issued overnight. Even after an agency has drafted a proposed regulation and managed to get it through internal agency review, interagency review can take up to 90 days (sometimes longer), then the public has an opportunity to comment for at least another 30 days, after which the agency must evaluate public comments and revise the rule accordingly before submitting it to another round of interagency review. Once published in the Federal Register, regulations generally are not effective for at least 30 to 60 days and, under the Congressional Review Act, Congress can pass a joint resolution disapproving regulations issued within the last six or seven months of an administration. All told, it easily can take a year between an agency's decision to propose a rule and the effective date of a final rule.

I met with regulatory agencies again in 2008 after the issuance of the Bolten memo, but it was not until the November 1 deadline for issuing final rules approached that many departments and agencies faced the realization that their time was up.

I expected to face strong resistance to the Bolten memo deadlines from political appointees who were turning into pumpkins on January 20, 2009. (Cochran had dubbed the rush to regulate the "Cinderella effect," comparing political appointees to Cinderella leaving the ball.) However, I was surprised that career employees, who would live to fight another day, also chafed at the Bolten memo deadlines. They had worked hard on many of the regulations nearing the finish line, and were disappointed when they did not make it across before January 20. The fate of regulations not issued by January 20 would be determined by the incoming administration, and I expect the

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career staff knew that there would be a delay, if not a policy change, and did not relish having to break in a new crew of political appointees before completing the project.

We faced tremendous pressure to grant "extraordinary circumstance" exceptions to the memo's deadlines, and the support of the Chief of Staff was essential. After careful consideration, Bolten settled on the following criteria for allowing an agency to issue final regulations past the November 1, 2008 deadline. Meeting these criteria did not guarantee that a regulation would be issued, but allowed it to commence interagency review. These regulations were still subject to the analytical requirements of Executive Order 12866.

1. For draft final regulations submitted to OIRA for interagency review before mid-October (two weeks before the deadline to issue a final rule), OIRA and the agencies worked expeditiously to conclude review. Once OIRA concluded review, agencies were allowed to publish these regulations, even if publication occurred after November 1. This exception accounted for 46 of the regulations issued after November 1, including a few that proved controversial, such as the Department of Interior's "mountain top mining" rules, the Treasury Department's restrictions on internet gambling, the Environmental Protection Agency's oil spill prevention and control regulations, and the Department of Housing and Urban Development's Real Estate Settlement Procedures Act regulations.

2. Final regulations that an agency identified as a high priority *and* had provided adequate public notice and opportunity for comment (generally defined as having met the June 1 deadline for publication of the proposed rule) were allowed to commence interagency review. The rationalization for this exception was that one of the primary problems with last-minute regulations is that they can be hurried, with inadequate public notice and opportunity for public comment. By insisting that interested members of the public were aware a regulation was underway and had an opportunity to comment on it, Bolten hoped to ensure better transparency. This category included a couple of controversial Department of the Interior regulations—changing the criteria for allowing guns in national parks and the ground rules for consulting with other agencies under the Endangered Species Act, among others.

3. Regulations that faced statutory or judicial deadlines were also granted exceptions, even if they did not meet the first two criteria, because the memo was not intended to avoid meeting obligations set by other branches of government. Twenty regulations meeting this criterion were published, and nine of those faced deadlines established by the 2008 Farm Bill.

4. The final extraordinary circumstance exception was for regulations that were considered presidential priorities. This category included several regulations designed to address the housing and financial market crises, as well as the controversial Department of Health and Human Services (HHS) "conscience protection" rule allowing medical practitioners not to perform services that violated their beliefs, HHS's new electronic coding scheme for medical diagnoses, and the Department of Justice's Americans with Disabilities Act (ADA) regulations. The ADA regulations commenced the OIRA-led interagency review, but due to its sweeping effects (estimated to cost private firms and municipalities over $1 billion per year), its complexity, and its overlap with other agency programs, DOJ was unable to complete the rule before the end of the administration.

With all these exceptions, was the memo successful? Well, my promises to staff that we would have a quiet holiday season after completing all regulatory activity by November proved to be wildly optimistic. All told, we would complete review of one-hundred significant final regulations between November 2008 and January 20, 2009. Nevertheless, I believe our efforts, and the Bolten memo in particular, had an important effect. It instilled needed discipline and forced regulatory agencies to make hard decisions about priorities. Without the memo, and OIRA's enforcement of it, dozens if not hundreds more regulations might have been issued in those final weeks. Caught by the memo's deadlines were high profile agency priorities such as the Department of Labor's risk assessment rule, EPA's new source review rule for electric utility generators, DOI's alternative energy rule, DOT's Corporate Average Fuel Economy rule, and the Treasury Department's alcohol labeling rule, just to highlight a few.

By any objective measure, the Bush 43 administration issued fewer regulations during the November to January post-election quarter (PEQ) than the previous administration.

Measure	PEQ 2008	PEQ 2000
Final regulations issued in PEQ	100	143
Final regulations during last three weeks	20	72
Final economically significant regulations in PEQ[2]	27	31
Federal Register Pages	21,000	27,000

However, the same cannot be said if we examine a longer time horizon, say the last 6 or 12 months. During the June to January period, slightly more regulations were issued by Bush 43 than by Clinton (212 vs. 209). From January 1, 2008 through January 20, 2009, the Federal Register printed 86,500 pages, a 7% increase over the same 13 month period a year earlier, but slightly less than the Clinton Administration's 91,800 pages during the same period (which in turn was 14% higher than the previous 13 month window).

Bottom line, I believe we did address some of the problems with midnight regulations. The early efforts to counteract the midnight regulation tendency did spread out the completion of regulations over a longer period, providing more time for constructive interagency review. Knowing how busy the 50-person OIRA staff was during the last three months, it is hard for me to imagine how they could have provided a thorough review of one and a half times as many rules, and impossible to fathom doing a constructive evaluation of 72 regulations in just 20 days. For the most part, the criteria for receiving an extraordinary circumstance exemption also ensured an opportunity for public comment.

I learned from my experience during the midnight hours of the Bush administration that midnight regulation is inevitable. The incentives and pressures to complete priorities is simply too great to abolish the phenomenon altogether. But there are actions that each branch of government can take to make sure regulations issued in the final months, which will have lasting impacts on the American public, are as accountable as possible.

First, the legislative branch can overturn regulations issued during the last six or seven months through a "joint resolution of disapproval" under the Congressional Review Act (CRA), although this is a blunt tool, and has only been used once, to overturn the Clinton Occupational Safety and Health Administration's midnight ergonomics rule. A resolution of disapproval is most likely to be effective during a transition from one political party to another, when the risk of a presidential veto is diminished. Though simpler than passing *de novo* legislation to address its concern, Congress may hesitate to use the CRA because, once disapproved, an agency cannot legally issue a "substantially similar" regulation.

The judicial branch may also have a role to play. Since regulations rushed at midnight may be more susceptible to challenge under the Administrative Procedure Act, the judicial branch may have an opportunity to weigh in and overturn poorly supported regulations, particularly if notice-and-comment procedures were shortchanged.

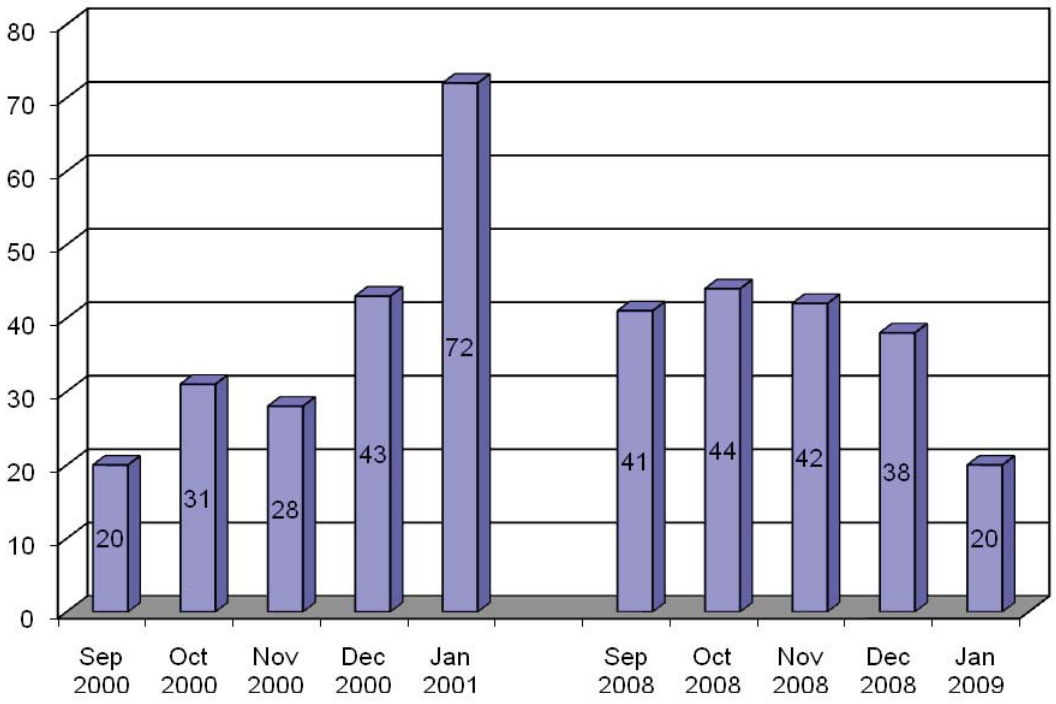
But the branch most likely to be effective at reigning in excessive midnight regulatory activity is the executive branch, through actions taken not only by the incoming but by the outgoing administration. As noted earlier, it has become a tradition for the incoming Chief of Staff to issue a memo on inauguration day halting the publication of any remaining regulatory actions and pulling back recent regulations not yet effective. I hope an outgoing Chief of Staff memo, like the one initiated by Josh Bolten, also becomes a tradition. It managed to head off the crush of regulatory activity in the final months and left key regulations for the incoming administration to imprint with its own policy stamp. The result was similar to what we saw in other aspects of the Bush-Obama transition: a gracious, respectful and orderly transfer of the President's authority over government regulation.

Endnotes

1 Jay Cochran III, "The Cinderella Constraint: Why Regulations Increase Significantly During Post-Election Quarters," Mercatus Center at George Mason University, March 2001. http://www.mercatus.org/uploadedFiles/Mercatus/Publications/The%20Cinderella%20Constraint(1).pdf.

2 Economically significant regulations are roughly defined as those with impacts greater than $100 million. The cutoff has not been adjusted for inflation. Because the definition of "significant regulation" changed in 1993, this is the only metric on which we can compare prior to 1993. Bush 41 issued 36 economically significant final regulations in PEQ 1992.

Regulations Completed in the Final Months of the Last Two Administrations



Source: www. Reginfo.gov.

Flip of a Coin?
The Appropriate Standard of Review in Government Licensing

*By Geoffrey W. Hymans & Daniel J. Appel**

> For the preservation, exercise, and enjoyment of these rights the individual citizen, as a necessity, must be left free to adopt such calling, profession, or trade as may seem to him most conducive to that end. Without this right he cannot be a freeman. This right to choose one's calling is an essential part of that liberty which it is the object of government to protect; and a calling, when chosen, is a man's property and right. Liberty and property are not protected where these rights are arbitrarily assailed.
>
> *The Slaughterhouse Cases* (1872) (Bradley, J., dissenting)

What standard of proof should the government meet to impose sanctions on an individual licensed by the state to practice his chosen profession? In a series of decisions this decade,[1] the Supreme Court of Washington State required the government to prove facts constituting "unprofessional conduct" by clear and convincing evidence.[2] Dissenters argue that, as a result of these decisions, "some of the state's most vulnerable citizens are now even more at risk for abuse."3 But there has been little empirical evidence to back these claims. Indeed, legislatively mandated biennial reports on the professional disciplinary process in Washington demonstrate that the higher burden of proof has had little effect on the imposition of licensing sanctions in the state.

I. Washington's Legal Landmarks

Prior to 2001, Washington's courts applied a preponderance of the evidence standard to professional disciplinary cases. Yet that year the Supreme Court of Washington accepted review of *Nguyen v. Washington State Department of Health*, a case that generated little attention when it had been decided by the state court of appeals earlier in the year (it had originally been issued as an unpublished decision), but would prove to be of great import.

Dr. Bang Duy Nguyen was a physician who had been accused by the state Medical Quality Assurance Commission of rendering unprofessional care in the treatment of twenty-two patients and of sexual misconduct with three patients. Following a six-day hearing, the Commission, applying a preponderance of the evidence standard, found that Dr. Nguyen had committed sexual misconduct with three patients, revoked his license indefinitely, and barred him from seeking relicensure for five years.

No Washington statute specifically set the standard of proof for administrative professional licensing cases. Yet the Washington State Department of Health, under general administrative-rule making authority granted in the state's Uniform Disciplinary Act, had adopted the following administrative rule: "Except as otherwise provided by statute, the burden in all cases is a preponderance of the evidence."[4]

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Dr. Nguyen claimed that the use of a "mere preponderance" standard violated his right to due process of law under the Fourteenth Amendment of the U.S. Constitution. He argued that the individual interests at stake in the revocation or restriction of a professional license were as important as interests the U.S. Supreme Court had already recognized as requiring a higher burden of proof. These interests included the liberty interest in not being civilly committed,[5] in not being deported or denaturalized,[6] and in not having ones parental rights terminated by the state.[7]

The court analyzed Dr. Nguyen's claims under *Mathews v. Eldridge*,[8] which set forth the U.S. Supreme Court's *übertest* for procedural due process. This test balanced the private interest affected by state action—the risk of erroneous deprivation through the procedures used—against the governmental interest in the added fiscal and administrative burden the additional process would entail. While the Supreme Court of Washington felt that these factors had only "uneven relevance and application" to the issue of what burden of proof should be required in any given circumstance,[9] it examined the interests under the *Mathews* framework.

The court first concluded that the private interest was substantial. It recognized that "loss or suspension of the physician's license destroys his ability to practice medicine, diminishes the doctor's standing in both the medical and lay communities, and deprives the doctor of the benefit of a degree for which he or she has probably spent countless hours and probably tens (if not hundreds) of thousands of dollars pursuing."[10] The court noted that it had long characterized professional disciplinary cases as "quasi-criminal," and noted that it had previously held that quasi-criminal bar disciplinary proceedings required no less than clear and convincing proof.[11]

The court found the risk of an erroneous result under a mere preponderance test to be high. It noted that the medical disciplinary board is investigator, prosecutor, and decisionmaker, and that the availability of judicial review provided "little solace" when, under the state's administrative procedures act, that review was "high on deference but low on correction of errors."[12] The court further examined the standard of conduct against which a professional actions are measured in a disciplinary case—in this case "incompetency, negligence, malpractice, moral turpitude, dishonesty, and corruption—and held that "it is difficult to imagine a more subject and relative standard than that applied in a medical disciplinary proceeding where the minimum standard of care is often determined by opinion, and necessarily so."[13]

Finally, the court examined the government interests at stake. It first discussed the government interests that may actually be weighed in determining the process due. Examining U.S. Supreme Court precedent, the court noted that "this requirement relates to the practical and financial burdens to be imposed upon the government were it to adopt a possible

substitute procedure for the one currently employed... [t]he requirement does not relate to the interest which the government attempts to vindicate through the procedure itself."[14] The court concluded that "an increased burden of proof would not have the slightest fiscal impact upon the state, as it would appreciably change the nature of the hearing *per se*."[15]

Balancing these factors, the court found that the higher burden of proof would protect critically important private interests with little or no additional burden on the state. Henceforth, clear and convincing evidence would be required in Washington to impose sanctions upon a physician.

But what about other professionals? The reach of the state in requiring government permission to practice a profession has exploded in recent years, and Washington State has certainly not lagged in this regard. In just the past few years the legislature has licensed[16] athletic trainers, animal masseuses, dental assistants, genetic counselors, speech-language pathology assistants, and landscape architects. This, in addition to the vast number of professional licenses already required by the state.[17]

Following *Nguyen*, Washington's lower appellate courts split on whether a clear and convincing burden of proof should apply to "lesser" professions. One court held that a mere preponderance could still be applied in imposing sanctions upon a real estate appraiser's license,[18] primarily because the resources expended in obtaining the license were less and therefore, according to this court, the individual's liberty and property interest in the license were diminished. In contrast, a different division of the Washington State Court of Appeals applied *Nguyen* in a matter involving a professional engineer's license.[19]

This set the stage for the issue's return to the Supreme Court of Washington in 2006. In *Ongom v. Department of Health*,[20] the court faced a rare factual situation where an administrative hearing officer found misconduct by a preponderance of evidence, but further concluded that the state had not proved its case by clear and convincing evidence. The matter involved a nursing assistant, a profession that, while licensed in Washington and subject to professional discipline under Washington statute, had minimal requirements to obtain a credential.[21]

The court reaffirmed *Nguyen* and applied it to all professional licenses in Washington, this time in a narrow 5-4 ruling. It rejected the state's arguments that "lesser" credentials should be subject to a lesser burden of proof because they represent less of an investment in education and training. "We cannot say Ms. Ongom's interest in earning a living as a nursing assistant is any less valuable to her than Dr. Nguyen's interest in pursuing his career as a medical doctor."[22]

The court also rejected a contention that the standard of proof should vary according to the actual sanction imposed. The state argued that where less than total revocation of the license was imposed, a lower burden of proof would suffice. This rather strange suggestion was met with the court's declaration that "we do not believe that the constitutional standard of proof in a proceeding can be determined only after the outcome is known.... The burden of proof does not differ based on result of a particular proceeding or the nature of the charges."[23]

Together, *Nguyen* and *Ongom* represent the most thorough recent analysis of the constitutionally required burden of proof in professional disciplinary cases. They also represent the high-water mark thus far in providing protection to the ever-increasing number of state-licensed professionals when they face efforts by the state to restrict, suspend, or revoke their licenses.

II. Other Jurisdictions

The *Nguyen* court accurately noted that "[s]tate precedent from other jurisdictions is divided" on the standard of proof required in professional disciplinary proceedings.[24] Some state courts have chosen or upheld the preponderance standard without addressing the constitutional ramifications of their decisions.[25] Others have summarily rejected any constitutional arguments in favor of the clear and convincing standard.[26] The courts that have carefully analyzed the Constitution's requirements under the Due Process clause have reached differing conclusions based primarily on different views of the interests involved. This section examines these cases, beginning with those upholding the preponderance standard.

A. Cases Upholding the Preponderance Standard

In one of the earlier cases to uphold the preponderance standard in the face of a due process challenge, the Supreme Court of New Jersey considered a doctor whose license to practice medicine was revoked by the State Board of Medical Examiners on the basis of various malpractice and professional misconduct claims.[27] In analyzing the due process issue, the court first noted that the preponderance standard of proof had "been consistently applied in agency adjudications for many years" before proceeding to the *Mathews* balancing test.[28] Beginning with the private interest—a medical license that is a property right "always subject to reasonable regulation in the public interest"[29]—the court discussed the purposes behind the various evidentiary standards.[30] Like *Nguyen*, *Polk* relied on *Addington* and *Santosky* to conclude that the clear and convincing standard applied to civil proceedings in which the loss suffered was comparable to criminal proceedings, such as a deprivation of liberty or a permanent loss of a significant interest.[31] *Polk* borrowed the same phrases used to describe interests that trigger the heightened standard, such as "particularly important" and "more substantial that mere loss of money," the loss of which poses a "significant deprivation of liberty" or is a "stigma."[32] In addition to the nature of the private interest, the *Polk* court also considered the extent of the loss, and noted that the loss of a medical license is not permanent in New Jersey; the licensee can reapply for licensure at a later date.[33] Even so, the court concluded that the private interest "is substantial and the potential deprivation great."[34]

Moving to the next *Mathews* factor, the government's interest,[35] *Polk* emphasized the right and duty of the government to protect the public, assuring its health and safety through regulating the medical profession.[36] In New Jersey, this interest trumps the doctor's interest in practicing medicine: "The right of physicians to practice their profession is necessarily subordinate to this governmental interest."[37] As described above, *Nguyen* limited the government's interests to the additional fiscal and

administrative burdens of applying the higher evidentiary standard. The Supreme Court of Washington refused to consider as part of its *Mathews* inquiry the "interest which the government attempts to vindicate through the procedure itself."[38]

Finally, *Polk* analyzed the third *Mathews* factor, the risk of erroneous deprivation. The Supreme Court of New Jersey framed the question as whether the preponderance standard "fairly allocates the risk of mistake between the two parties and sufficiently reduces for both the risk of an erroneous deprivation."[39] The court found the preponderance standard sufficient for several reasons. First, a medical license can be revoked in New Jersey only under "heightened and strict substantive standards," including "insanity, physical or mental incapacity, [and] professional incompetence," among others.[40] Second, the doctor has the ability to defend himself or herself with a full array of procedural safeguards, including representation by counsel and the ability to call witnesses.[41] And third, the nature of disciplinary proceedings minimizes the risk of error because all those involved—parties, witnesses, and the decision maker—are knowledgeable in the field, and the subject matter is not "elusive or esoteric" such that a higher evidentiary standard is needed to generate confidence in the outcome.[42] For these reasons, *Polk* concluded that the preponderance standard was sufficient to reasonably guard against mistakes, and thus to satisfy the constitutional demands of due process when balanced with the interests involved.[43]

Other state courts have reached similar conclusions. In *Gandhi v. State Medical Examining Board*, the Wisconsin Court of Appeals emphasized many of the same points as the *Polk* court in New Jersey.[44] *Gandhi* recognized the importance of the private interest and the tremendous deprivation suffered when a medical license is lost, but likewise noted that the license may be regained at a later date.[45] On the second factor, *Gandhi* emphasized the government's interest—indeed, its obligation—to protect the welfare of its citizens, which is "superior to the privilege of any individual to practice his or her profession."[46] Finally, *Gandhi* pointed to procedural safeguards protecting the licensee, and the composition of the tribunal—mostly physicians, who understand the substantive standards governing medical disciplinary proceedings.[47] Weighing these factors, the *Gandhi* court concluded that the preponderance standards comports with due process.[48]

In *North Dakota State Board of Medical Examiners v. Hsu*, the North Dakota Supreme Court examined this issue and reached the same conclusion.[49] *Hsu* discussed several cases on either side of the debate, including *Nguyen*, *Polk*, and *Gandhi*.[50] While admitting the physician's interest in his medical license was substantial, the *Hsu* court was persuaded that "the State's interest in protecting the health, safety, and welfare of its citizens is superior to a licensee's interest."[51] Further, *Hsu* minimized the state's role as investigator, prosecutor, and adjudicator, a fact that *Nguyen*, among others, used to support the clear and convincing standard.[52] Balancing these interests, *Hsu* upheld the preponderance standard.[53]

B. Cases Requiring the Clear and Convincing Standard

A number of states have adopted the clear and convincing standard without reference to the demands of constitutional due process.[54] At least one state has adopted the standard by statute.[55] Others, though, have reached that conclusion based on a *Nguyen*-like due process analysis. In *Johnson v. Board of Governors of Registered Dentists*, for example, the Supreme Court of Oklahoma discussed the standard of proof the Constitution requires in professional disciplinary proceedings, beginning with the purposes of the various evidentiary standards.[56] Like *Nguyen*, *Johnson* understood a professional medical license to be a protected property interest, the loss of which is penal in character and destroys a doctor's "means of livelihood."[57] *Johnson* recognized the state's interest "in the health, safety and welfare of its citizens," but considered the risk of erroneous deprivation to be high, particularly because the state agency is the investigator, prosecutor, and decisionmaker.[58] When balanced against the interests involved, this high risk of error led the *Johnson* court to hold that due process required clear and convincing evidence in professional disciplinary proceedings.[59]

Likewise, in *Painter v. Abels*, the Supreme Court of Wyoming, relying on *Johnson*, noted the "quasi-criminal" nature of these proceedings.[60] Applying the *Mathews* balancing test, *Painter* called the private interest "substantial" and divided the potential loss into three components: (1) the loss of a property right, (2) the loss of a livelihood, and (3) the loss of professional reputation.[61] Balancing this interest was the "state's interest in protecting the health, safety, and welfare of its citizens from a medical licensee's incompetence or misconduct."[62] Finally, like *Johnson*, *Painter* concludes that the risk of error is high because the same agency investigates, prosecutes, and decides.[63] For these reasons, *Painter* held that due process requires clear and convincing evidence.

As is evident from the above discussion, more states weighing the commands of due process have upheld the preponderance standard over the clear and convincing standard. But where the higher burden of proof has been applied, has it hindered the imposition of sanctions on licensees who have committed professional misconduct?

III. Effects & Lessons

One dissent in *Ongom* lamented that following *Nguyen* and *Ongom*, "some of this state's most vulnerable citizens are now even more at risk for abuse."[64] The lead dissent claimed that "the *Nguyen* majority's incorrect application of the *Matthews* test will harm the government's ability to protect the public from incompetent health care workers."[65] Have these dire predictions come to pass?

Not according to the data accumulated by the Washington State Department of Health. The Department is required by statute to produce an annual report on health professional discipline cases in Washington, a report which until 2008 was produced biennially.[66] This report contains data on the number of licensed professionals, the number of complaints, and the instances in which discipline was imposed for each reporting period.[67]

Nguyen was issued in August, 2001. During the 1999-2001 biennium, approximately 0.5% (.005) of the licensed health professionals in Washington received some form of discipline. In the preceding biennia the figures were 0.5% (1997-1999 biennium), 0.4% (1995-1997 biennium), 0.4% (1993-1995 biennium), 0.7% (1991-1993 biennium), and 0.5% (1989-1991 biennium).[68]

In the reports since *Nguyen* was issued the level of professional disciplinary sanctions imposed upon licensed Washington State health care professionals has been 0.7% (2001-2003 biennium), 0.6% (2003-2005 biennium), 0.6% (2005-2007 biennium), and 0.4% (for the 2008 initial annual report). Given an expected level of variation across biennia, one can hardly conclude that there has been a significant drop-off in the amount of discipline imposed while the state has operated under a clear-and-convincing evidence burden of proof. While the authors acknowledge that this is a rough measure, not accounting for other factors which may affect the imposition of discipline,[69] what is clear is that the sky has not fallen.

Upon reflection, the complaints of the *Ongom* dissenters seem misplaced. This is partly because increasing the burden of proof may only affect marginal cases which would have presented proof problems anyway. An agency may be less willing to take a case with significant evidentiary holes to hearing if they doubt they can convince a fact-finder to a clear-and-convincing degree.

But another reason the sky has not fallen is that the "burden of proof" is simply a measure of how certain a fact-finder must be that misconduct has been committed. It is not generally a measure of the quantum of proof necessary to meet that level of certainty. In Washington, even a single witness can be sufficient to prove a criminal case beyond a reasonable doubt.[70] Further, under the Washington State Administrative Procedures Act,[71] a court only reviews administrative decisions to determine if substantial evidence exists which supports an administrative law judge's factual findings, a fact noted by the *Nguyen* majority.[72] Finally, the disciplining authority in Washington remains (at least nominally) the investigator, the prosecutor, the fact-finder, and the imposer of professional discipline. It is unlikely that many cases exist comparable to *Ongom* where an administrative decisionmaker would admit to being convinced that misconduct occurred by a preponderance of evidence, but not clearly convinced.

Given these realities, we must ask ourselves whether the higher burden of proof actually has any utility in protecting a professional licensee's constitutional property and liberty interests. The authors intend to explore this further in their forthcoming article, but the most important role of the higher burden of proof is likely the rhetorical one. It allows a legal advocate to seed doubt in an administrative decisionmaker's (sometimes collective) mind by focusing on whether the decisionmaker has reached the required level of certainty. Perhaps, in this era of ever-increasing state regulation of professionals, that is all we can ask.

Endnotes

1 Ongom v. Dep't of Health, 148 P.3d 1029 (Wash. 2006); Nguyen v. Dep't of Health, 29 P.3d 689 (Wash. 2001).

2 The chapter of Washington's Laws governing the imposition of sanctions against licensed health professionals is Revised Code of Washington (RCW) Chapter 18.130, the Uniform Disciplinary Act (UDA). Conduct for which sanctions against a health practitioner's license can be imposed is denominated "unprofessional conduct" under that Chapter. See RCW 18.130.180.

3 *Ongom*, 148 P.3d at 144 (Madsen, J., dissenting).

4 Former Wash. Admin. Code 246-10-606.

5 Addington v. Texas, 441 U.S. 418 (1979).

6 Woodby v. INS, 385 U.S. 276 (1966); Chaunt v. United States, 364 U.S. 350 (1960).

7 Santosky v. Kramer, 455 U.S. 745 (1982).

8 424 U.S. 319 (1976).

9 *Nguyen*, 29 P.3d at 693.

10 *Id*. at 694.

11 *Id*. at 695.

12 *Id*.

13 *Id*. at 696.

14 *Id*.

15 *Id*.

16 In Washington there are three levels of "licensing"—licensing, certification, and registration. While these different licensure levels may have variations in the requirements to obtain the state-mandated credential (such as testing requirements), for purposes of imposing sanctions on a credentialed individual the different levels of licensing are indistinguishable. By way of example, all health care professionals, whether licensed, certified, or merely registered, are subject to the state's Uniform Disciplinary Act. *See* Revised Code of Washington Chapter 18.130.

17 *See* http://www.dol.wa.gov/listoflicenses.html. This list includes more than just professional licenses, but does include almost all professional licenses required by Washington State.

18 Edison v. Dep't of Licensing, 32 P.3d 1039 (Wash. Ct. App. 2001).

19 Nims v. Bd. of Registration, 53 P.3d 52 (Wash. Ct. App. 2002).

20 148 P.3d 1029 (Wash. 2006)

21 The dissent identified these requirements as the payment of a then $15 fee and the submission of an application. Ongom, 148 P.3d at 1039 (citing Wash. Admin. Code (WAC) 246-841-990(2); RCW 18.88A.080(1).

22 *Id*. at 1032.

23 *Id*. at 1033.

24 29 P.3d at 690.

25 *See, e.g.,* Ferguson v. Hamrick, 388 So.2d 981, 984 (Ala. 1980); Ethridge v. Ariz. Bd. of Nursing, 796 P.2d 899, 904 (Ariz. 1989); Johnson v. Ark. Bd. of Exam'rs in Psychology, 808 S.W.2d 766, 769 (Ark. 1991); Ga. Bd. of Dentistry v. Pence, 478 S.E.2d 437, 444 (Ga. Ct. App. 1996); Parrish v. Ky. Bd. of Med. Licensure, 145 S.W.3d 401, 410–11 (Ky. Ct. App. 2004); In re Wang, 441 N.W.2d 488, 492 (Minn. 1989); In re Wilkins, 242 S.E.2d 829, 841 (N.C. 1978), *abrogated in part on other grounds by* In re Guess, 376 S.E.2d 8 (N.C. 1989); Foster v. Bd. of Dentistry, 714 P.2d 580, 581–82 (N.M. 1986); Lyness v. State Bd. of Med., 561 A.2d 362, 367 (Pa. Commw. Ct. 1989).

26 *See, e.g.,* Snyder v. Colo. Podiatry Bd., 100 P.3d 496, 502 (Colo. Ct. App. 2004); Rife v. Dep't of Prof'l Reg., 638 So. 2d 542, 543 (Fla. Ct. App. 1994) (noting that constitutional due process did not require the clear and convincing standard but that a state statute did); Rucker v. Mich. Bd. of Med., 360 N.W.2d 154, 155 (Mich. Ct. App. 1984); Granek v. Tex. State Bd. of Med. Exam'rs, 172 S.W.3d 761, 777 (Tex. App. 2003) (citing Pretzer v.

Motor Vehicle Bd., 125 S.W.3d 23, 38–39 (Tex. App. 2003) *aff'd in part and rev'd in part*, 138 S.W.3d 908 (Tex. 2004)).

27 In re Polk, 449 A.2d 7, 11 (N.J. 1982).

28 *Id*. at 12–13.

29 *Id*. at 13.

30 *Id*. at 13–14.

31 *Id*.

32 *Id*.

33 *Id*. at 14.

34 *Id*.

35 Courts have altered the order of the last two *Mathews* factors, sometimes considering the government's interest before the risk of erroneous deprivation, *see id.* at 14–15, and sometimes the reverse, *see Nguyen*, 29 P.3d at 695–96.

36 Polk, 449 A.2d at 14.

37 *Id.* (citing Schireson v. State Bd. of Med. Exam'rs, 28 A.2d 879, 881 (N.J. 1942) *rev'd on other grounds*, 33 A.2d 911 (N.J. 1943)). While concluding that the government's interest was paramount, the court noted that the legislature had "significantly increased the substantive burden" the state bore to prove a discipline case by requiring proof of "particularly egregious" misconduct. *Id.* at 15.

38 29 P.3d at 696. The court reasoned in the alternative that even if the government's substantive interests are considered, the doctor still prevailed because the government's interest were advanced only when the proceedings reached an accurate result. *Id.* at 696–97.

39 *Polk*, 449 A.2d at 15.

40 *Id.*

41 *Id.* at 15–16.

42 *Id.* at 16.

43 *Id.*

44 483 N.W.2d 295 (Wis. Ct. App. 1992).

45 *Id.* at 299.

46 *Id.* The *Gandhi* court distinguished *Santosky* by contrasting parents' right to raise their children with the privilege (not the right) to practice medicine. *Id.* at 300.

47 *Id.*

48 *Id.*

49 726 N.W.2d 216 (N.D. 2007).

50 *Id.* at 228–30.

51 *Id.* at 230.

52 *See id.; Nguyen,* 29 P.3d at 695–96.

53 726 N.W.2d at 230. Other courts have reached the same conclusion using similar analysis or relied on a case that does so. *See, e.g.,* Sherman v. Comm'n on Licensure to Practice Healing Arts, 407 A.2d 595, 600–01 (D.C. 1979); Eaves v. Bd. of Med. Exam'rs, 467 N.W.2d 234, 237 (Iowa 1991); In re Grimm, 635 A.2d 456, 461 (N.H. 1993); Gould v. Bd. of Regents, 478 N.Y.S.2d 129, 130 (N.Y. App. Div. 1984); Gallant v. Bd. of Med. Exam'rs, 974 P.2d 814 (Or. Ct. App. 1999); Anonymous v. State Bd. of Med. Exam'rs, 496 S.E.2d 17, 19–20 (S.C. 1998); *In re Smith*, 730 A.2d 605, 609–13 (Vt. 1999).

54 *See, e.g.,* Storrs v. State Med. Bd., 664 P.2d 547, 555 (Alaska 1983); Silva v. Superior Ct., 14 Cal. App. 4th 562, 569–70 (1993); Ettinger v. Bd. of Med. Quality Assurance, 135 Cal. App. 3d 853, 855–56 (1982); Cooper v. Bd. of Prof'l Discipline, 4 P.3d 561, 568 (Idaho 2000); Schireson v. Walsh, 187 N.E. 921, 923 (Ill. 1933); Allen v. La. Bd. of Dentistry, 531 So. 2d 787, 798 (La. Ct. App. 1988), *rev'd on other grounds*, 543 So. 2d 908 (La. 1989); McFadden v. Miss. Bd. of Licensure, 735 So. 2d 145, 152 (Miss. 1999); Davis v. Wright, 503 N.W.2d 814, 818 (Neb. 1993); In re Zar, 434 N.W.2d 598, 602 (S.D. 1989).

55 Fla. Stat. Ann. § 458.331(3).

56 913 P.2d 1339 (Okla. 1996).

57 *Id.* at 1345; *see also id.* at 1346 ("[T]he interest of the [doctor is] substantial. The [doctor] suffers the possible loss of a constitutionally protected property right, the loss of a livelihood, and the loss of a professional reputation. These losses are greater than monetary losses.").

58 *Id.*

59 *Id.* at 1347. The Supreme Court of Oklahoma later reaffirmed Johnson's due process. *See* Robinson v. State ex rel. Okla. State Bd. of Med. Licensure & Supervision, 916 P.2d 1390 (Okla. 1996).

60 998 P.2d 931, 941 (Wyo. 2000).

61 *Id.*

62 *Id.*

63 *Id.*

64 *Ongom*, 148 P.3d at 144 (Madsen, J., dissenting).

65 *Id*. (Owens, J., dissenting).

66 RCW 18.130.310. This statute was amended in 2008 Laws of Washington, chapter 134, section 13, to change from biennial to annual reporting.

67 These reports are available at http://www.doh.wa.gov/hsqa/Professions/Publications/UDA.htm.

68 While a report was produced for the 1987-1989 biennium, the reporting categories were dissimilar so comparison is problematic.

69 The budget a state agency has to expend on disciplinary activities is one such factor. Another can be substantive changes to the discipline statutes, either increasing or decreasing the realm of activities that would constitute unprofessional conduct. The authors are currently analyzing these variables and hope to include their analysis in a longer law review article to be published on this same topic.

70 State v. Jenkins, 766 P.2d 499 (Wash. Ct. App. 1989).

71 RCW Chapter 34.05.

72 *See Nguyen*, 29 P.3d at 695 (quoting RCW 34.05.570(3)(e)). In fact, this standard is even more deferential than it first appears, since the statute requires a reviewing court to view the case "in light of the whole record before the court" and the Washington Supreme Court has placed the burden on reviewing courts to independently undertake a search of the record for evidence that might be considered "substantial." *See* Faghih v. Dep't of Health, 202 P.3d 962 (Wash. Ct. App. 2009).

Article 1, Section 8 of the Constitution: A Private Right of Action for Citizens Seeking Equal Protection under U.S. Immigration Laws

*By Michael J. Brady & Tony Abdollahi**

Thousands of citizens in this country are confronted with an odd dilemma—they are unable to get public educational benefits that are available to illegal aliens. Ironically enough, this problem began when Congress decided to put American citizens on equal footing with illegal aliens in 1996, with 8 U.S.C. § 1623, which provided that if a state granted post-secondary educational benefits to illegal aliens, the same benefits must be awarded to American citizens.

> Notwithstanding any other provision of law, an alien who is not lawfully present in the United States shall not be eligible on the basis of residence within a State (or a political subdivision) for any postsecondary education benefit unless a citizen or national of the United States is eligible for such a benefit (in no less an amount, duration, and scope) without regard to whether the citizen or national is such a resident.[1]

By identifying a benefited class, however ("a citizen or national of the United States" denied a "postsecondary education benefit"), § 1623 created a private right of action. In turn, numerous states triggered claims under § 1623 by enacting legislation simultaneously granting tuition benefits to illegal aliens while denying them to American citizens.[2] In response to the ensuing lawsuits, states have invoked in defense sovereign immunity, as manifested by both the Eleventh Amendment and the "new federalism" of Supreme Court jurisprudence in the 1990s.

One obvious recourse for students confronted by this defense has been to sue under the Fourteenth Amendment. As one of the Civil War amendments, the Fourteenth Amendment is meant to redress discrimination and, for this reason, enjoys a primacy that vitiates sovereign immunity. However, states argue that there is no private right of action under the Fourteenth Amendment and, while relief is available under 42 U.S.C. § 1983, such an action (1) is allegedly subject to a state's sovereign immunity, and (2) only allows for a damages action against a "person," not the state. Accordingly, 8 U.S.C. § 1623—and any similar statute mandating equal protection for American citizens relative to illegal aliens—appears to be a right in need of a remedy.

But because § 1623 is an immigration statute, relief is available under the Constitution. Article I, Section 8 states that Congress has the power "[t]o establish an uniform Rule of Naturalization, and uniform Laws on the subject of Bankruptcies throughout the United States." As Alexander Hamilton wrote in the *Federalist*, Congress' power over naturalization is exclusive; the states waived their sovereign immunity relative thereto in 1789.

In the course of the past decade, numerous federal courts, including the Supreme Court, have grappled with the scope of the federal bankruptcy power *vis-à-vis* a state's sovereign immunity. Does a bankrupt entity's "dischargability" complaint or action for "transfers" pierce a state's sovereign immunity? The answer, the courts have found, is yes, and in reaching this result they have relied on Hamilton's conclusion that the primacy of the Naturalization Clause abrogates sovereign immunity in holding that the bankruptcy power (also based on Article I, Section 8, Clause 4) pierces sovereign immunity. Given that Hamilton's conclusion regarding the primacy of the naturalization power served as the predicate for a right of action under the bankruptcy provision, it follows that a private right of action exists under the naturalization provision as well.

A. How the New Federalism of the 1990s Resurrected Sovereign Immunity as a Defense

During the 1990s, the Supreme Court issued a series of decisions that came to be known as the "new federalism." Chief among these, for our purposes, were *Seminole Tribe of Florida v. Florida*[3] and *Alden v. Maine*.[4] Based on the Commerce Clause, they collectively held that (1) a federal right of action does not abrogate state sovereign immunity, and (2) that the application of sovereign immunity does not depend on whether the action is maintained in state or federal court. Purportedly, both also leave victims of state-sponsored discrimination without a forum to vindicate their federal rights.

Seminole Tribe may have been a reaction to a 1970s decision by the Court that acknowledged Congress' ability to create a federal right of action in accordance with Section 5 of the Fourteenth Amendment. In *Fitzpatrick v. Bitzer*,[5] the Court held that Congress has the power to abrogate the state's Eleventh Amendment sovereign immunity so long as it does so to enforce the guarantees of the Fourteenth Amendment.

> When Congress acts pursuant to Section 5, not only is it exercising legislative authority that is plenary within the terms of the constitutional grant, it is exercising that authority under one section of a constitutional Amendment whose other sections by their own terms embody limitations on state authority. *We think that Congress may, in determining what is 'appropriate legislation' for the purpose of enforcing the provisions of the Fourteenth Amendment, provide for private suits against States or state officials which are constitutionally impermissible in other contexts.*[6]

The tension between *Seminole Tribe* and *Fitzpatrick* is a recent example of an issue that has troubled the Supreme Court since the inception of our Union—Congress' ability to create a federal claim versus the states' sovereign immunity. Just five years after the Constitution was adopted, the Court in *Chisholm v. Georgia*[7] held that Congress had the power to create a private cause of action against a state for a violation of a federal right.

> In swift reaction to the *Chisholm* decision, and out of fear that the decision would authorize an onslaught of suits against the States by private individuals seeking to recover on war debts, Congress proposed, and the States subsequently ratified, the Eleventh Amendment.[8]

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Two centuries later, the Court stated that *Chisholm*, and not the Eleventh Amendment, deviated from the original understanding of the Constitution, which was to preserve the states' traditional immunity from suit. "The text and history of the Eleventh Amendment also suggest that Congress acted not to change but to restore the original constitutional design."[9] Accordingly, "[t]he Eleventh Amendment and cases interpreting it generally prohibit citizens from suing a state without its consent."[10]

The revival of sovereign immunity was inaugurated by *Seminole Tribe*,[11] wherein the Court invoked the Eleventh Amendment to conclude that Congress lacks the power to abrogate the states' sovereign immunity. "Even when the Constitution vests in Congress complete lawmaking authority over a particular area, the Eleventh Amendment prevents congressional authorization of suits by private parties against unconsenting States."[12] The Court's conclusion was buoyed by a "background principle" of immunity that extended beyond the Amendment.[13]

Three years after *Seminole Tribe*, the Court expanded on its holding and held that sovereign immunity applies regardless of whether the forum is a state or a federal court. In *Alden v. Maine*,[14] a group of probation officers filed suit in federal court against the State of Maine, alleging a violation of the Fair Labor Standards Act. While that action was pending, *Seminole Tribe* was decided, prompting the plaintiffs to dismiss the federal complaint and re-file in state court. Building upon the principle articulated in *Seminole Tribe*, the Court observed

> the sovereign immunity of the States neither derives from, nor is limited by, the terms of the Eleventh Amendment. Rather, as the Constitution's structure, its history, and the authoritative interpretations by this Court make clear, the States' immunity from suit is a fundamental aspect of the sovereignty which the States enjoyed before the ratification of the Constitution, and which they retain today…[15]

The court continued, "private suits against nonconsenting States … present the indignity of subjecting a State to the coercive process of judicial tribunals at the instance of private parties, regardless of the forum."[16] The Court accordingly concluded that sovereign immunity bars suits in state courts just as it does in federal courts: "the powers delegated to Congress under Article I of the United States Constitution do not include the power to subject nonconsenting States to private suits for damages in state courts."[17]

The new federalism manifested by *Seminole Tribe* and *Alden* had, to say the least, a chilling effect on the enforcement of federal rights. Of course, sovereign immunity under the Eleventh Amendment does not extend to a prospective action for injunctive relief.[18] However, a victim of state-sponsored discrimination seeking retrospective relief was left without a forum. This was exacerbated by the uncertain scope of these decisions at the time they were published. Although federal courts have clarified—and in some cases limited—the scope of *Seminole Tribe* and *Alden*, state institutions continue to cite these decisions in defense to federal civil rights actions to this day. However, the new federalism of *Seminole Tribe* and *Alden* does not afford the states with a defense to claims based on Section 5 of the Fourteenth Amendment or statutes promulgated under the immigration power of Congress.

B. 8 U.S.C. § 1623 Gives Citizens Equal Protection as to Educational Benefits

1. Section 1623 is an Equal Protection Statute and Part of Congress' Avowed Policy of Deterring Illegal Immigration

In August 1996, Congress enacted the Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA) to restrict immigration and the status of immigrants.[19] Title IV of the Act placed limits on the ability of immigrants, both legal and illegal, to obtain benefits from government agencies. One month later, in September 1996, Congress followed up with the Illegal Immigration Reform and Immigrant Responsibility Act of 1996 (IIRIRA).[20]

The foregoing statutes reflected a clear intent by Congress to deny public benefits to illegal aliens, both as a matter of general policy and as specifically applied to educational benefits. "It is a compelling government interest to remove the incentive for illegal immigration provided by the availability of public benefits."[21] Congress mandated that aliens be self-sufficient rather than rely on public resources.[22]

As part of the IIRIRA, Congress also enacted 8 U.S.C. § 1623, which proscribes a state from providing postsecondary educational benefits to illegal aliens unless all American citizens are provided the same benefits.

> The more persuasive inference to draw from § 1623 is that public post-secondary institutions need not admit illegal aliens at all, but if they do, these aliens cannot receive in-state tuition unless out-of-state United States citizens receive this benefit.[23]

Accordingly, § 1623 creates a private right of action. As recognized by the Supreme Court, "[f]or a statute to create such private rights, its text must be 'phrased in terms of the persons benefited.'"[24] By requiring that a state grant a "postsecondary education benefit" to out-of-state American citizens in the same "amount, duration, and scope" as illegal aliens, § 1623 vests a private right of action to a benefited class—i.e., "a citizen or national of the United States."[25]

Moreover, § 1623 bears the indicia of an equal protection statute.[26] It presents two classes—illegal aliens and out-of-state American citizens—and mandates equal treatment between them. States must provide the same post-secondary educational benefits to American citizens as they do to illegal immigrants. However, the manner in which certain states render the educational benefits—e.g., allegedly based on high school attendance, rather than (according to these states) residence—results in out-of-state American citizens being denied equal benefits. As it seeks to redress this result, § 1623 is an equal protection statute under the Fourteenth Amendment.

"The Equal Protection Clause of the Fourteenth Amendment commands that no state shall 'deny to any person within its jurisdiction the equal protection of the laws,' which is essentially a direction that all persons similarly situated should be treated alike."[27] In this regard, "[w]hen a state distributes benefits unequally, the distinctions it makes are subject to scrutiny under the Equal Protection Clause of the Fourteenth

Amendment. Generally, a law will survive that scrutiny if the distinction it makes rationally furthers a legitimate state purpose."[28]

Accordingly, by distributing education benefits based on whether a student is an illegal immigrant or an American citizen, states that grant tuition benefits to the former while denying them to the latter have implicated the Fourteenth Amendment.

2. Although an Equal Protection Statute under the 14th Amendment Pierces Sovereign Immunity, Remedies are Limited under 42 U.S.C. § 1983

Seminole Tribe and *Alden* addressed federal statutes enacted under the Commerce Clause. However, as an equal protection (and privileges and immunities) statute, § 1623 is based on Section 5 of the Fourteenth Amendment. While sovereign immunity arises from principles of federalism, the Fourteenth Amendment—enacted in response to the discrimination arising from the Civil War era—alters this relationship and supersedes traditional state immunity. Accordingly, the immunity manifested by *Seminole Tribe* and *Alden* is either inapplicable to or distinguishable from an action founded on an equal protection statute under the Fourteenth Amendment. There are, however, important limitations on a significant remedy—those under 42 U.S.C. § 1983—under the Fourteenth Amendment.

"Congress' enforcement authority is at its apex when fashioning remedies aimed at the core Fourteenth Amendment guarantee of Equal Protection."[29] The Supreme Court has noted that legislation based on Section 5 the Fourteenth Amendment is entitled to a dignity not accorded to legislation based on the Commerce Clause.

> Congress may not abrogate the States' sovereign immunity pursuant to its Article I power over commerce. *Seminole Tribe, supra.* Congress may, however, abrogate States' sovereign immunity through a valid exercise of its Section 5 power, for "the Eleventh Amendment, and the principle of state sovereignty which it embodies, are necessarily limited by the enforcement provisions of Section 5 of the Fourteenth Amendment."[30]

Thus, the "new federalism" attributed to *Seminole Tribe* is inapplicable to actions predicated on the Fourteenth Amendment.

> Although *Seminole Tribe* has closed the Article I abrogation avenue, Congress may still abrogate Eleventh Amendment immunity pursuant to Section 5 of the Fourteenth Amendment, which provides that "Congress shall have the power to enforce, by appropriate legislation, the provisions of this article."[31]

Therefore, if a court decides that a statute such as § 1623 was intended to create a private right of action and that the statute was enacted under Congress' powers under Section 5 of the Fourteenth Amendment, then monetary relief directly against the state is appropriate.

The usual remedy sought for a violation of the Fourteenth Amendment is to invoke 42 U.S.C. § 1983, which authorizes an action for damages for violation of any law of the United States or of the Constitution. There is, however, a significant impediment to such an action—a claim under § 1983 is subject to sovereign immunity and damages are limited to a "person," not the State.

> Under 42 U.S.C. § 1983, an aggrieved individual may sue persons who, acting under color of state law, abridge rights, immunities, or privileges created by the Constitution or laws of the United States. It is settled beyond peradventure, however, that neither a state agency nor a state official acting in his official capacity may be sued for damages in a § 1983 action.[32]

Moreover, the Supreme Court has acknowledged that "42 U.S.C. § 1983 does not override States' Eleventh Amendment immunity."[33] Accordingly, while "[c]ourts have long recognized that 42 U.S.C. § 1983 was enacted pursuant to Congress' enforcement powers under the Fourteenth Amendment and creates a private cause of action… the Supreme Court has definitively stated that § 1983 does not abrogate a State's Eleventh Amendment sovereign immunity."[34]

Since monetary relief under § 1983 is limited to "persons" and not the State itself, another basis must be found for addressing the discrimination effected by denying the equal educational benefits to American citizens.

C. Private Right of Action under Article 1, Section 8

In dictating that states grant the same educational benefits to American citizens as illegal aliens, § 1623 identifies a benefited class and creates a private right of action enforceable under the Fourteenth Amendment. This brings us to the proposition that—separate and apart from the Fourteenth Amendment—because § 1623 is an immigration statute, a private right of action exists under Article I, Section 8 and the states cannot rely on sovereign immunity as a defense thereto.

In the wake of *Seminole Tribe* and *Alden*, federal courts have been confronted with the primacy of Congress' bankruptcy power *vis-à-vis* state sovereign immunity, an issue that arises where a bankrupt entity files a "dischargability" complaint or an action for "transfers" against the state directly. Federal courts have acknowledged the existence of this right of action under Article I, Section 8 of the Constitution.

Section 8 requires that Congress establish "uniform" rules regarding naturalization and bankruptcy. Alexander Hamilton reasoned that this mandate necessarily meant that Congress' power over naturalization was exclusive and, as a result, that states had waived their sovereign immunity. Since the bankruptcy provision is also founded on Article I, Section 8, recent federal decisions have relied on Hamilton's analysis to conclude that Congress has exclusive power over bankruptcy and, as a result, that sovereign immunity is unavailable as a defense.

Based on this conclusion, federal decisions have permitted a private right of action in bankruptcy claims against a state. Because the bankruptcy power and naturalization power are in the same constitutional provision and Hamilton found a waiver of sovereign immunity in the context of the bankruptcy power, it follows that a private right of action exempt from sovereign immunity also exists under the Article I, Section 8 naturalization power.

1. Congress has Plenary Control over Immigration Arising from the U.S. Constitution

The power over immigration is rooted in Section 8:

> [t]he Court recognizes the preeminent role of the United States Government with respect to the regulation of aliens within its borders. The sources of its authority include the Federal Government's power 'to establish a uniform Rule of Naturalization,' U.S. Const., Art. I, sec. 8, cl. 4, its power to 'regulate Commerce' with foreign Nations, cl. 3, and its broad authority over foreign affairs.[35]

Since it is predicated on the Constitution itself, the Supreme Court has long recognized that Congress has plenary control over immigration unmatched regarding any other subject matter.

> [T]he power to exclude aliens is inherent in sovereignty, necessary for maintaining normal international relations and defending the country against foreign encroachments and dangers—a power to be exercised exclusively by the political branches of government… [o]ver no conceivable subject is the legislative power of Congress more complete than it is over the admission of aliens.[36]

In light of Congress' exclusive control over immigration, "*[t]he power over aliens is of a political character and therefore subject to only narrow judicial review*."[37]

That the power over immigration is based on the structure of the Constitution itself has special significance. Because it derives from—and, indeed, apparently transcends—the structure of the Constitution, the immigration power is "unmatched" relative to other matters. Similarly, the nature of its basis means that the immigration power is political and subject to narrow judicial review. Since 8 U.S.C. § 1623 is an immigration statute and Congress' immigration power under Article I, Section 8 of the Constitution is supreme, an action under § 1623 implicates political issues—i.e., Congress' avowed desire to disincentivize illegal immigration—and is subject to narrow judicial scrutiny. The clear import of this is that a court should have little leeway in proceedings involving equal protection actions brought under federal immigration statutes such as § 1623. If a state grants tuition benefits to illegal aliens, it must grant the same benefits to qualifying American citizens.

2. A Private Right of Action under the Bankruptcy Power Indicates a Similar Right under the Immigration Power

Analogizing the bankruptcy power to the immigration power, federal courts have applied Hamilton's analysis regarding the latter to hold that the former—also based on Article I, Section 8—abrogates state sovereign immunity. In concluding that states have no sovereign immunity regarding bankruptcy proceedings, federal courts were required to acknowledge the corresponding supremacy of the naturalization power. As the courts have found that there is a right of action against the states in a bankruptcy action, it follows that a similar right of action exists under the immigration power.

In *Central Virginia Community College v. Katz*,[38] the Supreme Court relied on Hamilton's thoughts in the *Federalist* to clarify that the holding in *Seminole Tribe* did not apply to the Bankruptcy Clause. "We acknowledge that statements in both the majority and the dissenting opinions in [*Seminole Tribe*] reflected an assumption that the holding in that case would apply to the Bankruptcy Clause. [Citation]. Careful study and reflection have convinced us, however, that that assumption was erroneous."[39]

The Court noted that at the time the Constitution was drafted the colonies still maintained a policy of imprisoning debtors and had divergent rules regarding bankruptcy.[40] The Framers proposed "[t]o establish uniform laws upon the subject of bankruptcies," whereupon "[a] few days after this proposal was taken under advisement, the Committee of Detail reported that it had recommended adding the power 'to establish uniform laws upon the subject of bankruptcies' to the Naturalization Clause of what later became Article I."[41] Having thus bundled the Bankruptcy Clause with the Naturalization Clause, the Court held that sovereign immunity was compromised under the former. "[T]he Bankruptcy Clause's unique history, combined with the singular nature of bankruptcy courts' jurisdiction, discussed *infra*, have persuaded us that the ratification of the Bankruptcy Clause does represent a surrender by the States of their sovereign immunity in certain federal proceedings."[42]

In the wake of *Seminole Tribe* and *Alden*, two federal court decisions have been at the forefront in recognizing a private right of action under the Bankruptcy Clause of Section 8. In *Bliemeister v. Industrial Com.*,[43] a shop owner was sued by a hired worker for an injury arising in the course of employment. As the plaintiff did not have workers' compensation insurance, the state industrial commission paid the claim and brought an action for reimbursement. In response to the state's claim, the plaintiff filed for Chapter 7 bankruptcy and brought a "dischargeability complaint." The state argued that "a dischargeability complaint constitutes a 'suit' for Eleventh Amendment purposes,"[44] but the court disagreed. Distinguishing *Chisholm*, the court resolved that the issue of sovereign immunity must be addressed by examining the structure of the Constitution as aided by the *Federalist*:

> [T]o determine the scope of sovereign immunity, we must look not to the language of the Eleventh Amendment, but to the structure of the original Constitution and, even more importantly, the historical understanding at the time when the Constitution was originally adopted of those areas where state sovereignty was retained and where it was surrendered. The Court has been consistent in interpreting the adoption of the Eleventh Amendment as conclusive evidence "that the decision in *Chisholm* was contrary to the well-understood meaning of the Constitution," *Seminole Tribe*, 517 U.S. at 69, and that the views expressed by Hamilton, Madison, and Marshall during the ratification debates, and by Justice Iredell in his dissenting opinion in *Chisholm*, reflect the original understanding of the Constitution. And of those interpretative sources, probably the single most important is Hamilton's analyses in The Federalist Papers, the most significant and often quoted being Federalist No. 81.[45]

The court held that because the bankruptcy power was contained in the same provision as the naturalization power, Hamilton's reasoning applied with equal force to the bankruptcy power. "The bankruptcy power is granted to the federal government by the very same clause that Hamilton used to exemplify the third method by which the Constitution alienates

states' sovereignty, and contains the same word used to signify that limitation on states' sovereignty."[46] Having cited Section 8 as the common basis for both, the court concluded that the states surrendered sovereign immunity as to the naturalization power and the bankruptcy power. "[A]s Hamilton indicated, the framers had taken 'the most pointed care' to specify the states' surrender of their sovereignty on these very few, carefully selected subjects. *The states no more retained sovereign powers over bankruptcy laws than they did over naturalization*."[47]

In *In re Hood*,[48] the Sixth Circuit echoed *Bliemeister*, holding that a bankruptcy appellate panel correctly distinguished *Seminole Tribe* to conclude that the bankruptcy and naturalization powers dictate a surrender of state power over the respective subjects.

> Although the panel acknowledged that *Seminole Tribe of Florida v. Florida*, could be interpreted as precluding Congress from ever abrogating states' sovereign immunity under any of its Article I powers, *the panel interpreted The Federalist No. 81 and No. 32 to distinguish bankruptcy, along with naturalization, from the rest of the Article I powers*. The panel noted that, with respect to bankruptcy and naturalization, the Constitution granted Congress the power to establish 'uniform Laws,' U.S. Const. Art. I, sec. 8, cl. 4, not mere laws. According to the panel, *The Federalist* No. 32 shows that Congress' power to make uniform laws required states to surrender their own power to make such laws and thus an important degree of their sovereignty. Because limits on sovereignty are by their very nature limits on sovereign immunity, the panel concluded that Congress' power to make laws on bankruptcy carries with it the power to abrogate states' sovereign immunity.[49]

Together, *Bliemeister* and *Hood* are the seminal cases in support of the principle that Congress' immigration power under Article I, Section 8 serves as the analogical basis for its power under the bankruptcy provision. Accordingly, ensuing decisions have relied on *Bliemeister* and *Hood* to abrogate a State's sovereign immunity and find a private right of action in bankruptcy proceedings under Article I, Section 8.

A bankruptcy court in Vermont relied extensively on *Hood* to conclude that a debtor could maintain a dischargeability complaint against the State in derogation of sovereign immunity. In *In re Flores*,[50] a Chapter 7 debtor filed a complaint against Vermont seeking a determination of the dischargeability of a scholarship obligation. However, "[t]he State did not file an answer; instead, it asserted the defense of sovereign immunity in a Motion to Dismiss."[51] The court observed, "[t]he issue presented is whether the State's sovereign immunity protects it from having to defend an action that seeks a determination of the dischargeability of the scholarship obligation the Debtor owes to it before this Court."[52]

The court relied on *Hood* and its interpretation of the *Federalist* to clarify the scope of *Seminole Tribe* as it related to sovereign immunity.

> In its attempt to delineate the boundaries of Congress' powers, the Supreme Court may have painted its picture of sovereign immunity in the *Seminole Tribe* case with an overly broad brush. A careful analysis of Article I, and The Federalist Papers, that have been relied upon extensively to interpret the intentions of the Framers of the Constitution, persuades this Court that a finer brush is needed to circumscribe Congress' powers. This Court finds the Sixth Circuit has used just such a brush in its meticulously researched, well-reasoned, and very persuasive decision in [Hood]. This Court adopts the Hood court's analysis as to the proper scope of sovereign immunity abrogation in the context of bankruptcy, and its conclusion that the State may not avoid dischargeability proceedings by donning the cloak of a sovereign entity.[53]

Significantly, a Massachusetts district court has relied on *Federalist* Nos. 32 and 81, as interpreted by *Hood* and *Bliemeister*, to hold that sovereign immunity does not protect state universities from a bankruptcy action pursuant to Article I, Section 8 of the Constitution. In doing so, the Court expressly recognized a private right of action under the naturalization provision.

In *In re Dehon*,[54] a bankruptcy plan administrator filed suit against the University of Alaska, Florida State University, and the University of Texas, seeking to avoid and recover transfers regarding each defendant under §§ 547, 550 of the Bankruptcy Code. The court observed that since the actions "have the potential of requiring the Defendants to turn over funds to the Plan Administrator for distribution under the Bankruptcy Code, they clearly qualify as suits under the Eleventh Amendment."[55] The court accordingly observed, "the issue is thus: whether Congress may create private rights of action against the States when acting pursuant to Article I, section 8, clause 4 of the Constitution—the bankruptcy power."[56]

The court stated that the Eleventh Amendment abrogation analysis underlying *Seminole Tribe* was inapplicable to a private right of action based on the original plan of the Constitution.

> If, however, the States' sovereign immunity with respect to congressional action under a particular Article I power was altered by the original plan of the Constitution, Congress has the ability to create private causes of action in federal courts pursuant to that power and abrogation is unnecessary. This is so because if the Constitution itself contemplated the abrogation of sovereign immunity in a particular area, the Eleventh Amendment does not act to restore the states to their pre-ratification sovereign status.[57]

Relying on the interpretation accorded to *Federalist* Nos. 32 and 81 by *Hood* and *Bliemeister*, the court reiterated that Section 8 was identical in scope as to both the naturalization and bankruptcy power, and a private rights suit could be maintained against the state under either.

> [I]t is clear from The Federalist Nos. 32 and 81 that the Constitution's drafters intended the grant of power over naturalization to completely alienate the States' sovereign immunity with respect to naturalization matters. *Hood*, 319 F.3d at 766; *In re Bliemeister,* 251 B.R. at 389-90 … [g]iven the structure of the Constitution and the Framers' decision to use the word 'uniform' in both cases, it appears that the Framers intended to treat the powers given to Congress over naturalization and bankruptcy as identical in scope. *Hood*, 319 F.3d at 766; *In re Bliemeister*, 251 B.R. at 389-90. *Since the Framers' express intent was to alienate State sovereign immunity from suit when Congress exercises its power over naturalization,* it must be deduced that the Framers intended to alienate States' sovereign immunity with respect to the bankruptcy power as well.[58]

Significantly, it has been held that the analysis in *Hood* and *Bliemeister* regarding the basis and scope of Congressional power over immigration and bankruptcy under Article I, Section 8 of the Constitution is not inconsistent with the principles espoused by the Supreme Court.

> The analysis in *Hood* and *Bliemeister* of Hamilton's expositions in Federalist Nos. 81 and 32 leading to the conclusion in *Bliemeister* that sovereign immunity was surrendered in the plan of the convention with respect to Congress' power to enact uniform laws of naturalization and bankruptcy does not conflict with any Supreme Court decision on the subject of the Eleventh Amendment and sovereign immunity.[59]

Accordingly, the reasoning used to effectuate a private right of action under the bankruptcy power demonstrates an analogous right under the immigration power. This conclusion is consistent with the interpretation afforded to Section 8 by *Bliemeister* and *Hood* under the *Federalist*. According to Hamilton, the mandate under Section 8 to "establish an uniform Rule of Naturalization" means that Congress' power over immigration is exclusive. Accordingly, federal decisions have relied on the naturalization provision to effectuate a private right of action under the bankruptcy provision.

As Section 8 of the Constitution serves as the basis for both powers, the federal courts' acknowledgement of the *Federalist* as the implied justification regarding the bankruptcy power necessarily requires the recognition of the naturalization power as an equal justification. "Hamilton's reasoning with respect to naturalization can be applied with equal force to bankruptcy."[60] Thus, the unique constitutional mandate giving rise to a private right of action against the states in a bankruptcy action should apply with equal force to an action based on an immigration statute. Since the mandate to establish uniform laws is the basis for a private right of action under the bankruptcy power and the same mandate exists regarding the naturalization power, there must be a private right of action under federal immigration laws.

Akin to a complaint under the bankruptcy code, 8 U.S.C. § 1623 confers a similar right, giving American citizens equal educational benefits as those granted to illegal aliens. Since it is an immigration statute, § 1623 is based on the Naturalization Clause of Article I, Section 8 of the Constitution and is not subject to the abrogation analysis reflected in *Seminole Tribe*. Accordingly, a private right of action for equal educational benefits under § 1623 should proceed without interference from a state's sovereign immunity defense.

CONCLUSION

In enacting § 1623, Congress meant to deter illegal immigration and to discourage illegal aliens from staying in the United States. Instead of totally prohibiting the grant of in-state tuition to illegal aliens (which Congress could have done) it chose instead a more gentle approach, respectful of federalism, and decreed that if a state did grant in-state tuition to illegal aliens it must grant the same benefit to American citizens from another state.

But Congress did not anticipate the boldness of the states in flaunting its will. Numerous states have granted this significant benefit to illegal aliens, while denying it to out-of-state American citizen students. Presumably, these states believe that they are protected from significant exposure because of sovereign immunity. But these states ignore the fact that § 1623 is a Section 5 Fourteenth Amendment statute giving Congress the power to identify situations—e.g., illegal aliens versus out-of-state American students—and decree that equal protection will be required under those circumstances *and* that the same privileges granted to illegal aliens must be granted to out-of-state American students.

Perhaps even more importantly, because § 1623 is an immigration statute, Section 8 is a means by which American citizens can vindicate their equal protection rights *vis-à-vis* illegal aliens. As reflected by recent bankruptcy cases, Congress' plenary power over immigration means that sovereign immunity is no defense to an action for relief brought pursuant to an immigration statute or pursuant to Congress' immigration power. In giving hundreds of thousands of American citizens a private right of action for a violation of their equal protection rights, Section 8 makes state institutions financially responsible for the uneven distribution of public benefits afforded to illegal aliens.

Endnotes

1 8 U.S.C. § 1623 (parenthesis in original).

2 States adopting laws that grant tuition benefits to illegal aliens—usually in the form of an exemption from out-of-state tuition—include Texas, California, New York, Utah, Illinois, Washington, Nebraska, New Mexico, Oklahoma, and Kansas.

3 Seminole Tribe of Florida v. Florida, 517 U.S. 44 (1996).

4 Alden v. Maine, 527 U.S. 706 (1999).

5 Fitzpatrick v. Bitzer, 427 U.S. 445 (1976).

6 *Id.* at 456 (emphasis added).

7 Chisholm v. Georgia, 2 U.S. 419 (1793).

8 In re Dehon, Inc., 327 B.R. 38, 45 n.12 (D.Mass. 2005).

9 *Alden, supra* note 4, at 722.

10 Minnesota v. United States, 102 F. Supp. 2d 1115, 1122-1123 (D.Minn. 2000), citing Kimel v. Florida Bd. of Regents, 528 U.S. 62 (2000).

11 *Seminole Tribe, supra* note 3, 517 U.S. 44.

12 *Id.* at 72.

13 *Id.*

14 *Alden, supra* note 4, at 706.

15 *Id.* at 713.

16 *Id.* at 749.

17 *Id.* at 712.

18 *See generally* Green v. Mansour, 474 U.S. 64, 68 (1985) ("The landmark case of *Ex parte Young*, 209 U.S. 123, 28 S.Ct. 441, 52 L.Ed. 714 (1908)… held that the Eleventh Amendment does not prevent federal courts from granting prospective injunctive relief to prevent a continuing violation of federal law.")

19 Pub. L. No. 104-193, 110 Stat. 2105 (1996).

20 Pub. L. No. 104-208, div. C, 110 Stat. 3009-546-3009-724 (1996).

21 8 U.S.C. § 1601(6).

22 8 U.S.C. § 1601(2).

23 Equal Access Educ. v. Merten, 305 F.Supp.2d 585, 606-607 (E.D.Va. 2004).

24 Gonzaga University v. Doe, 536 U.S. 273, 284 (2002); Cannon v. University of Chicago, 441 U.S. 677, 692, n. 13 (1979).

25 *See* Israeli Aircraft Indus. Ltd. v. Sanwa Bus. Credit Corp., 850 F.Supp. 686 (N.D.Ill. 1993) ("Plaintiff is correct in his assertion that courts have found an implied private right of action when a statute grants a right to a benefited class of persons or identifies a class of persons Congress meant to benefit.")

26 Section 1623 is not only an "equal protection" statute but also a statute under the Fourteenth Amendment's "privileges and immunities" clause. Illegal aliens have been granted the *privilege* of being exempt from non-resident tuition—i.e., paying resident tuition—and U. S. citizens from other states under §1623 must be granted the *same privilege*.

27 City of Cleburne v. Cleburne Living Center, Inc., 473 U.S. 432, 439 (1985); Plyler v. Doe, 457 U.S. 202, 216 (1982).

28 Zobel v. Williams, 457 U.S. 55, 60 (1982).

29 Dare v. California, 191 F.3d 1167, 1174 (9th Cir. 1999).

30 Nevada Dept. of Human Res. v. Hibbs, 538 U.S. 721, 726-727 (2003).

31 Georgia Higher Educ. Assistance Corp. v. Crow, 394 F.3d 918, 922 (11th Cir. 2004); *see also* Oregon Short Line R.R. v. Dep't of Revenue Oregon, 139 F.3d 1259, 1268 (9th Cir. 1998).

32 Johnson v. Rodriguez, 943 F.2d 104, 108 (1st Cir.1991) (citation omitted), citing Will v. Mich. Dept. of State Police, 491 U.S. 58, 71 (1989) ("We hold that neither a State nor its officials acting in their official capacities are 'persons' under § 1983.")

33 Pennhurst State School & Hosp. v. Halderman, 465 U.S. 89, 99 (1984), citing Quern v. Jordan, 440 U.S. 332, 342 (1979).

34 Clift by Clift v. Fincannon, 657 F.Supp. 1535, 1542 (E.D.Tex. 1987).

35 United States v. Chen De Yian, 905 F.Supp. 160, 166 (S.D.N.Y. 1995).

36 Kleindienst v. Mandel, 408 U.S. 753, 765-766 (1972); *see also* Kwon v. Comfort, 174 F.Supp.2d 1141, 1144-1145 (D.Colo. 2001) ("Congress' near-complete power over immigration transcends the specific grant of authority in Article 1, Section 8 of the Constitution, and derives from the inherent and inalienable right of every sovereign and independent nation to determine which aliens it will admit or expel.")

37 Hampton v. Mow Sun Wong, 426 U.S. 88, 101 n.21 (1976) (emphasis added); *see also,* Herrera-Inirio v. INS, 208 F.3d 299, 308 (1st Cir. 2000) ("Because Congress has plenary power to make policies and rules concerning the exclusion of aliens, see U.S. Const. art. I, § 8, cl. 4; the immigration process is, in the last analysis, frankly political in character. The courts' authority to scrutinize legislation in this field is correspondingly narrow.")

38 Central Virginia Cmty. Coll. v. Katz, 546 U.S. 356 (2006).

39 *Id*. at 363.

40 *See also* In re Mayes, 294 B.R. 145, 163 (10th Cir. 2003) ("The uniformity requirement of the bankruptcy clause arose in a specific historical context. Prior to the Constitution, states regulated bankruptcy. States could and did imprison debtors. The laws were different from state to state. The bankruptcy clause was meant to address this situation by bringing bankruptcy into the federal realm and creating a national uniform law.")

41 *Katz*, *supra* note 38, at 368-69.

42 *Id*. at 369, n.9.

43 Bliemeister v. Indus. Com., 251 B.R. 383 (D.Ariz. 2000).

44 *Id*. at 386.

45 *Id*. at 387.

46 *Id*. at 389.

47 *Id*. at 389-90 (emphasis added); *see also*, King v. State of Florida, 280 B.R. at 772 ("Like naturalization, the bankruptcy clause requires uniformity. Hence, Hamilton's reasoning with respect to naturalization can be applied with equal force to bankruptcy.")

48 In re Hood, 319 F.3d 755 (6th Cir. 2003), *aff'd*, Tennessee Student Assistance Corp. v. Hood, 541 U.S. 440 (2004).

49 *Id*. at 759 (emphasis added); *see also* Sherwood Partners, Inc. v. Lycos, Inc., 394 F.3d 1198, 1201 (9th Cir. 2005) ("There can be no doubt that federal bankruptcy law is 'pervasive' and involves a federal interest 'so dominant' as to 'preclude enforcement of state laws on the same subject'—much like many other areas of congressional power listed in Article I, Section 8, of the Constitution, such as patents, copyrights, currency, national defense and *immigration*.") (Emphasis added.)

50 In re Flores, 300 B.R. 599 (D.Vt. 2003).

51 *Id*. at 601.

52 *Id*.

53 *Id*. at 602.

54 In re Dehon, *supra* note 8, at 38.

55 *Id*. at 45.

56 *Id*. at 47.

57 *Id*. at 48.

58 *Id*. at 54-55 (emphasis added).

59 Metromedia Fiber Network, Inc. v. Various State & Local Taxing Auth., 299 B.R. 251, 268-269 (S.D.N.Y. 2003).

60 *King, supra* note 47, at 772.

Civil Rights

France Says *Non* to Affirmative Action: Will the U.S. Do the Same?

*By Elizabeth K. Dorminey**

After devoting a half-century to devising (new) justifications for differential treatment of citizens on the basis of race, the Supreme Court appears, at last, to be edging towards a plainer meaning of the Constitution's Equal Protection Clause: one that would prohibit the practice. At the same time, on the other side of the Atlantic, French President Nicolas Sarkozy commissioned a study group to determine whether France's Constitution could (or should) be altered to permit "positive discrimination" (as "affirmative action" is rendered in French) to address that country's social inequities. Simone Veil, a highly respected member of the Académie Française, former President of the European Parliament, and member of France's Constitutional Council, was selected for this task, and in December 2008 declared that any such change would be fundamentally incompatible with France's core values of *liberté, égalité,* and *fraternité.* With its recent decision in a case brought by white firefighters in New Haven, Connecticut, who alleged that they were denied promotions after passing a test that was scrapped because very few minority candidates achieved passing grades, the Supreme Court has moved a step closer—but not all the way—to declaring that differential treatment on the basis of race is unconstitutional.

These parallel developments afford an opportunity for a comparative look at French and U.S. affirmative action and anti-discrimination laws. This article suggests that in both nations, whose traditions and constitutions have much in common, the principle of equality before the law is paramount and should guide both judges and legislators.

The U.S. Declaration of Independence (1776) asserts that "all men are created equal, [and] that they are endowed by their Creator with certain unalienable Rights, [] among these [] Life, Liberty, and the pursuit of Happiness." The Fourteenth Amendment to the U.S. Constitution (1868) provides that "No State shall... deny to any person within its jurisdiction the equal protection of the laws." Written only a few years after the Declaration of Independence, France's Declaration of the Rights of Man and of Citizens (1793) provides in Article VI: "All the citizens, being equal in [the eyes of the law], are equally admissible to all public dignities, places, and employments, according to their capacity and without distinction other than that of their virtues and of their talents." The Preamble to the Constitution of the Fifth Republic (1946) declares in Article I that "the French republic is indivisible, secular, democratic, and social. It assures equality before the law of all citizens without distinction based on origin, race, or religion, and respects all creeds. Its organization is decentralized. The law favors equal access by men and women in all matters relating to voting and election, and to professional and social opportunities." (Unofficial translation.) The similarities are undeniable.

On this side of the Atlantic, the Supreme Court has wrestled with the problems of equal protection and affirmative action, with varying degrees of success, for a half-century France has confronted the problem more recently, and Mme Veil's committee concluded that, given the country's law, history, and traditions, and the way affirmative action has evolved in other countries, notably the United States, differential treatment cannot be reconciled with the principles of "*liberté, egalité, et fraternité*."

Many countries have experimented with affirmative action programs, particularly in public education and government contracting, but their fairness and effectiveness have been hotly debated. In *Affirmative Action around the World: An Empirical Study* (2004), the American economist Thomas Sowell analyzed affirmative action programs in India, Malaysia, Sri Lanka, Nigeria, and the United States, and concluded that affirmative action programs rarely benefit those they are intended to help. Instead, they tend to exacerbate tensions between preferred and non-preferred groups, often with unexpected, even disastrous results, conferring additional benefits mainly on the already privileged elite of the targeted population.

In the United States, affirmative action programs designed to achieve racial diversity in education have been challenged both in the courts and at the polls.[1] The Supreme Court recently invalidated race-based assignments to public elementary and secondary schools in Seattle on constitutional grounds, concluding that assigning pupils to schools based on their race was incompatible with the Constitution's principle of equal treatment, whatever the societal benefits of racial integration.[2]

The legality of affirmative action programs in the university setting is less clear. In some recent cases, academically qualified white students, denied admission to university programs in favor of less academically qualified minority students, have challenged affirmative action programs on equal protection grounds. A federal court in Texas invalidated that state's minority preference program, but courts in other states, and the Supreme Court, have held that the goal of achieving a diverse student body can justify state-sponsored discrimination.[3] Although some states have enacted race-neutral and sex-neutral admission criteria—adopting, for example, admissions criteria linked to geography or class rank—the Supreme Court most recently held that states may still use race-based preferences in admissions at the university level, without violating the Equal Protection Clause, so long as there is what the Court regards as a good reason for practicing such discrimination.[4]

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There also have been vigorous court challenges to another category of affirmative action—set-asides for minority contractors bidding on public works projects—again with mixed results.[5] Preferences in these programs are justified in much the same manner as education. The government has claimed that preferential treatment for some minority groups is necessary to promote social and economic progress, as well as to erase the effects of past discrimination, and the Court has allowed them to do so as long as the program passes "strict scrutiny." Yet, frequently, as Sowell found in his study, those of the underrepresented minority groups who are granted the benefits of these set-aside programs are wealthy builders and contractors who already enjoy considerable economic success, much in the same manner as race-based preferences in higher education often help the sons and daughters of affluent minority-group members gain admission over less privileged, nonminority applicants with similar credentials. In the United States and in other countries, such programs have led to charges of "window dressing," where "minority ownership" is a veneer that results in only a few, successful members of the minority class actually reaping the benefits of the "set-aside" contracts. Thus, as Sowell notes, these affirmative action programs can exacerbate existing hostility between members of the preferred and non-preferred classes and lead everyone to question the achievements of every member of the preferred class.

France, of course, has both a different constitution and a different history, but as a diverse society faces many of the same problems of high levels of crime and social unrest among minorities who are disproportionately unemployed and undereducated. In 2004 President Nicolas Sarkozy proposed revising the Preamble to the French Constitution to permit members of certain minorities to gain access to opportunities in education and employment on a preferential basis. To study this proposal, President Sarkozy commissioned Mme Veil to assemble a committee and prepare a report. Her answer, released in December 2008, was a resounding "no."[6]

Its mission was to consider the creation of constitutional rights to facilitate solutions to complex social problems, and to that end, the committee studied affirmative action policies from many countries, including the United States, heard testimony from more than two dozen individuals, and made a searching examination of French law and policy, as well as an examination of other countries' laws and policies. In the end, it was France's distinct history, dating back to the Declaration of the Rights of Man and of Citizens (1793) that was decisive. Mme Veil's committee concluded that preferences simply cannot be reconciled with the overriding principle of equality that is central to the French state. The committee advanced four broad reasons for its conclusions.

First, laws that treat citizens differently based on their racial or ethnic background are only justified in countries where such groups have been victims of de jure discrimination in the past. For example, in the United States, slavery during much of the 19th century and segregation during much of the 20th were enforced by law. France has no history of state-sanctioned, race-based discrimination. This appears to be the principal reason that Veil's committee found affirmative action to be arguably justifiable in countries like the United States and South Africa but unjustifiable in France.

Second, the committee found that it would be paradoxical, to say the least, to adopt affirmative action programs at a time when, in even those countries like the United States, where there is a history of *de jure* discrimination, such measures are falling out of favor. The Veil Report cited the obvious tension between affirmative action and the 14th Amendment of the United States' Constitution noted in the *Bakke* decision,[7] and quoted with approval Chief Justice Roberts' comment in the *Seattle School District* case that "[t]he way to stop discrimination on the basis of race is to stop discriminating on the basis of race."[8]

Third, there are definitional difficulties. "Race" and "origins" are hard to define, and even harder to assign, particularly in a country like France where there has been a high degree of intermarriage and very strong resistance to the idea of documenting or collecting statistical data based on race, religion, and ethnicity. This would pose substantial practical obstacles to the implementation of any "positive discrimination" program.

Fourth, as Sowell noted in his study, the Veil committee found that preferences for certain groups would impair the ability of all French citizens to live together in harmony because they would breed resentment between favored and non-favored communities.

Having been charged with considering the creation of new constitutional rights to facilitate preference programs to redress the challenging social problems of unemployment and undereducation in minority communities and promoting diversity, the committee concluded that these problems could be resolved within the existing constitutional framework and no change was warranted. This the committee distilled to three ideas.

First, the committee found that the principal shortcoming of the current set of constitutional "tools" to redress these problems was not that they were inadequate, but that they were underutilized. In its current form the French Constitution protects a broad array of rights, offering arguably the greatest protection of rights available to citizens of any western nation.[9] Upon this base the Constitutional Council, France's highest juridical body, has developed a jurisprudence that has significantly enriched these fundamental rights. The risk of undue expansion of rights through "judge-made law" has always been checked by the corrective power of Parliament. The committee considered its report to be a step in the direction of making existing rights better known to the populace. Moreover, the French Constitution is not the only protector of basic rights. An ensemble of international and European Community laws, conventions, and treaties offer additional protection, and French judges, by virtue of Article 55 of the Constitution, may take these into account, and may refuse to enforce a domestic law if it is found to be contrary to international norms.

Second, the committee considered that any reform of the Preamble to the Constitution should have widespread popular support, reflecting a general consensus of public opinion, and that was lacking. The importance of such consensus was recognized in President Sarkozy's charge to the committee. The

committee answered this charge by consulting diverse sources encompassing many differing philosophies and backgrounds. No consensus on the desirability of a constitutional amendment promoting diversity emerged.

Third, the committee concluded that leaving the Constitution alone would not preclude salutary social change. In fact, the opposite is true. There is a wealth of constitutional resources presently available to bring about the desired outcomes, without tampering with the constitution. To that end, the Veil Report recommended renewed emphasis on the enforcement of laws that prohibit discriminatory treatment. If "positive discrimination" is prohibited, negative discrimination also is proscribed. A country in which rights are not guaranteed by law may as well not have any constitution at all. The path to real equality lies through the constitution's guarantee of equal treatment for all.

In closing the committee stressed that there was nothing illegitimate about its mission. Quite the opposite: their study identified better ways than a change to the Preamble to bring about the desired result. The Veil Report enumerates not impossibility, but myriad possibilities for progress through the application of existing law; specifically, laws that prohibit and provide redress for acts of discrimination.

Policies in the United States designed to combat discrimination—to ensure that individuals are not treated less well than other similarly situated individuals because of their race, age, gender, sexual orientation, disability, religion, or national origin—have enjoyed broad support. Title VII of the Civil Rights Act of 1964 explicitly prohibits discrimination in employment, and established the Equal Employment Opportunity Commission (EEOC) to handle individuals' complaints of discrimination against their employers.[10] The EEOC provides a forum for the filing, investigation, mediation, and (sometimes) resolution of specific discrimination claims. Prior to actually filing a discrimination lawsuit, a party must comply with the EEOC's administrative procedures. The EEOC is authorized to file suit on behalf of an individual, but does so only in a very small proportion of the cases it investigates. Most discrimination cases that end up in federal court are brought by individuals, singly or in groups, rather than by the government. However, the plaintiffs in these lawsuits are real people, with specific and concrete claims that they have been discriminated against on the basis of some prohibited factor. Unlike the broad demographic groups to whom the benefits of affirmative action are directed, these claimants are not anonymous members of a class that the government has determined to be entitled to preferential treatment based on historical mistreatment, but individuals with current, real grievances who seek redress.

As Mme Veil's committee noted, the European Union has directed its member states to adopt programs to combat discrimination. In compliance with that directive, France has established an entity called the High Authority to Combat Discrimination and For Equality (*Haute Autorité de Lutte Contre les Discriminations et Pour l'Égalité*, or HALDE).[11] Established in 2004, this organization could fulfill many of the same functions that the EEOC has in the United States, by providing a forum for the adjustment of individual complaints of discrimination, and could also serve an important educational function: to inform employers and landlords of their responsibilities, as well as to educate individuals about their rights. Investing this organization with the resources necessary to carry out its mission could produce lasting benefits to society while remedying individual wrongs and would certainly be consistent with the Veil Report's admonition to make better use of available law.

In the U.S., the EEOC is authorized to seek money damages, up to a cap of $300,000, for violations. If the EEOC is not successful in resolving a claim, the aggrieved individual is authorized to file a lawsuit to seek redress. The financial liability not only of potential damages, but also the cost of defense, serves as a powerful deterrent. The U.S. has earned an unfortunate reputation as an excessively litigious society, but the threat of severe financial penalties can influence corporate behavior in positive ways. On a practical level, the EEOC is largely a self-funded program that does not depend exclusively upon government allocations to survive, but instead counts on individual litigants acting as "private attorney-generals" to enforce the law. In contrast to the EEOC, the HALDE is a relative newcomer, having been established only in 2004, in a country where litigation rarely produces the magnitude of money damages that have made lawsuits such a popular pastime in the United States. As with the EEOC, anyone who believes they are the victim of discrimination may file a written complaint with the HALDE, but its emphasis so far is on education and mediation rather than litigation, and monetary awards (so far) are modest and infrequent.

Like the EEOC, the HALDE can only address forms of discrimination that are prohibited by law, not all manifestations of bias or unfairness. The program is still in its infancy. In its fourth annual report, published in May 2009, the HALDE reported that in 2008 it processed 917 complaints concerning discrimination in employment and housing: 25% percent alleged discrimination based on race, 17% alleged disability discrimination, and 8% alleged age discrimination, with other complaints concerning family status and union activity making up the remainder.[12] In contrast, the EEOC reported that in FY 2008 it received 95,402 complaints.[13] The scope of the HALDE is also being tested. In May 2009 the mayor of Courneuve, a western suburb of Paris, filed a complaint with the HALDE on behalf of his city against President Sarkozy, alleging that the President and government discriminated against his city, and has encouraged other municipalities to join in the action.[14] It does not appear that the architects of this program contemplated its use by municipalities against the State. It remains to be seen how the Courneuve action will proceed, and how effective the HALDE will prove as a remedy for discrimination in France.

The U.S. Supreme Court recently had another opportunity to explore the fine points of race discrimination in employment. This term the Court decided *Ricci v. DeStefano*,[15] reversing the Second Circuit's decision that had affirmed summary judgment for the city in a case brought by 18 firefighters in New Haven, Connecticut, who alleged that the city violated Title VII and the Equal Protection Clause of the Constitution, when it refused to make any promotions following administration of a promotions exam on which only one minority candidate received a passing grade.

The New Haven case shines a spotlight on employment practices and some intensely political aspects of the affirmative action debate. To avoid the appearance of bias, New Haven, at considerable expense, had contracted with a professional test-writing firm to prepare and administer a race-neutral promotions exam to its firefighters. In 2003, 118 applicants took the test for promotion to the ranks of captain and lieutenant: 41 candidates (25 white, 8 black, and 8 Hispanic) took the captain test, and 77 applicants (43 white, 19 black, and 15 Hispanic) took the lieutenant test. When the examinations were scored, no blacks, and at most 2 Hispanics, achieved scores that made them eligible for promotion to captain; and no blacks or Hispanics scored well enough to be eligible for promotion to lieutenant. Expressing concern that it might face an employment discrimination lawsuit from nonwhite candidates if the results of the exam were certified, the city refused to certify the results and no promotions at all were made.

The city successfully avoided suit by nonwhite applicants; the white applicants sued instead. The district court granted summary judgment for the defendant city, finding that the political motivation to avoid making promotions that might appear to be racially biased did not, as a matter of law, constitute racial discrimination, and thus that the plaintiffs had failed to marshal sufficient evidence to prevail on their Title VII claim. A panel of the Second Circuit Court of Appeals initially granted a summary affirmance. The firefighters moved for rehearing en banc, which gave rise to a contentious order in which the requested rehearing was denied, over strident dissents, by the majority. The panel withdrew its summary affirmance and adopted the district court's decision as its own.

The Supreme Court, in a 5-4 split, found in favor of the firefighters. Justice Kennedy, writing for the majority, concluded that all the evidence pointed to the conclusion that the city had thrown out the test results because the higher scoring candidates were white. This was an express, race-based decision, and decisions based on race, the Court held, are only justifiable where there is a "strong basis in evidence" that impermissible disparate impact amounts to an illegitimate racial preference:

> [U]nder Title VII, before an employer can engage in intentional discrimination for the asserted purpose of avoiding or remedying an unintentional disparate impact, the employer must have a strong basis in evidence to believe it will be subject to disparate-impact liability if it fails to take the race-conscious, discriminatory action.[16]

In briefs to the Supreme Court, the city had questioned the race neutrality of the promotion tests, suggesting that this justified rejecting the results. This issue had not been raised before the district court or the Second Circuit.[17] Justice Kennedy, writing for the five-justice majority, and Justice Alito, in a concurring opinion joined by Justices Scalia and Thomas, soundly rejected this argument, pointing to voluminous evidence in the record that showed that the city had spent $100,000 on a consultant to prepare a scrupulously race-neutral written exam, and had engaged independent assessors from outside Connecticut, two-thirds of whom were minority group members, to serve as assessors for the oral portion of the exam. The majority found that the city's decision to reject the promotions test results was motivated by the race of those who passed, and that this violated Title VII's prohibition of racial discrimination.

In a typically concise and pungent separate concurrence, Justice Scalia noted that *Ricci* leaves for another day the inevitable battle between Title VII's prohibition on disparate treatment and its approval of remedies for "disparate impact."[18] "Title VII's disparate impact provisions place a racial thumb on the scales, often requiring employers to evaluate the racial outcomes of their policies, and to make decisions based on (because of) those racial outcomes."[19] Justice Scalia concludes: "[T]he war between disparate impact and equal protection will be waged sooner or later, and it behooves us to begin thinking about how—and on what terms—to make peace between them."[20]

In a dissent joined by Justices Stevens, Souter, and Breyer, Justice Ginsburg says that the majority "pretends" that the city threw out the test results based on the successful test-takers' race, and fails to take account of a history of racial discrimination in its own and other cities around the country.[21] She noted that the plaintiffs in *Ricci* "attract this Court's sympathy" (to which Justice Alito, in his concurrence, replied: "'Sympathy' is not what petitioners have a right to demand. What they have a right to demand is evenhanded enforcement of the law....").[22] Justice Ginsburg focused on alleged flaws in the test and on history, and reaffirmed her view of the legitimate role of disparate impact in righting past wrongs.[23] Indeed, her point is well-taken if one agrees that the Court, in the name of justice, may legitimately subordinate process to results. Not everyone agrees with that, and the polarizing tension between these two camps is what drives 5-4 splits and confirmation battles.

On January 20, 2009 Barack Obama became the first African-American President of the United States. Does this mean that we have achieved a color-blind society? That would be nice, but it is probably not true. Was he selected because we have already had 43 white presidents and it was time for a black man to get the job? Certainly not. Did he benefit from race-based affirmative action in education and employment? We do not know, and likely, never will, but the mere existence of such programs will always give his detractors an opportunity to cast doubt on his accomplishments. Preferences cause problems. This lingering doubt and distrust make it hard to achieve the ideal society envisioned by Dr. Martin Luther King, Jr., where people are "judged on the content of their character, not the color of their skin."

On the other hand, it is indisputable that President Obama's election is the direct product of laws that prohibit discrimination against a person on the basis of race. In the segregated South, state laws preventing blacks from voting, attending schools, shopping at stores, visiting restaurants and hotels, and using public transportation on an equal footing with whites persisted well into the 1960s. Such laws were fundamentally at odds with the plain meaning of the Equal Protection Clause, but somehow courts had worked a way around those words. Ironically, it was a Supreme Court decision that authorized segregation in the first place, holding that "separate but equal" was a legitimate reason for the State to treat people differently on the basis of their race.[24]

In *Grutter* Justice O'Connor found the law school's race-conscious admission program to be sufficiently narrowly tailored

to serve the compelling state interest of attaining a critical mass of underrepresented minority students. However, she said that the Court was mindful that a

> core purpose of the Fourteenth Amendment was to do away with all... governmentally imposed discrimination based on race…. Accordingly, race-conscious admissions policies must be limited in time…. We see no reason to exempt race-conscious admissions programs from the requirement that all governmental use of race must have a logical end point.[25]

Justice O'Connor then continued:

> We take the Law School at its word that it would "like nothing better than to find a race-neutral admissions formula" and will terminate its race-conscious admissions program as soon as practicable. It has been 25 years since Justice Powell first approved the use of race to further an interest in student body diversity in the context of public higher education. Since that time, the number of minority applicants with high grades and test scores has indeed increased…. We expect that 25 years from now, the use of racial preferences will no longer be necessary to further the interest approved today.[26]

Twenty five years separated *Bakke* and *Grutter*, and Justice O'Connor seems to be suggesting that another 25 years of preferences may do the trick. The Supreme Court's decision in *Northwest Austin Mun. Utility Dist. No. One v. Holder*[27] to allow the Voting Rights Act, reauthorized in 2006 for another 25 years, certainly supports this timetable, though the Court's opinion foreshadows the war between rights and remedies in the context of voting rights as well.

With the Veil Report, France declared that equal protection trumps remedial action, and thus avoided the conflict that has simmered, and occasionally boiled, in the U.S. for a century. A slim majority in *Ricci* adopted a more stringent test—"a strong basis in evidence"—to justify race-conscious remedies, but, as Justice Scalia observes, this is not a resolution: "[T]he war between disparate impact and equal protection will be waged sooner or later, and it behooves us to begin thinking about how—and on what terms—to make peace between them."[28] The American Civil War of the 19th century was a protracted, bloody, and emotional affair. The Civil Rights War of the 20th century, conducted in large part to remedy the effects of the 19th century conflict, continues into the 21st. It remains to be seen when, and on what terms, it will end.

Endnotes

1 Voters in four states—California, Washington, Michigan, and most recently Nebraska—have passed ballot initiatives to prohibit their state governments from engaging in any form of affirmative action. In Colorado in 2008, a similar ballot initiative lost by a very narrow margin.

2 Parents Involved in Community Schools v. Seattle School District 1, 127 S.Ct. 2738 (2007).(Roberts, C.J.) (parents brought action against school district challenging, under Equal Protection Clause, student assignment plan that relied on racial classification to allocate slots in oversubscribed high schools; *held,* allegedly compelling interest of diversity in higher education could not justify districts' use of racial classifications in student assignment plans, *abrogating Comfort v. Lynn School Comm.,* 418 F.3d 1 (1st Cir. 2005); and districts failed to show that use of racial classifications in their student assignment plans was necessary to achieve their stated goal of racial diversity).

3 *Cf.* Hopwood v. Texas, 78 F.3d 932 (C.A.5 1996) (Hopwood I) (holding that diversity is not a compelling state interest); *with* Smith v. University of Wash. Law School, 233 F.3d 1188 (9th Cir. 2000) (holding that it is); *and* Doe v. Kamehameha Schools/Bernice Pauahi Bishop Estate, 470 F.3d 827 (9th Cir. 2006) (school's policy of giving preference to students of Native Hawaiian ancestry did not violate 42 U.S.C. § 1981).

4 Grutter v. Bollinger, 539 U.S. 306, 123 S.Ct. 2325, (2003) (O'Connor, J.) (law school had a compelling interest in attaining a diverse student body; and admissions program was narrowly tailored to serve its compelling interest in obtaining the educational benefits that flow from a diverse student body, and thus did not violate the Equal Protection Clause); Gratz v. Bollinger, 539 U.S. 244, 123 S.Ct. 2411 (2003) (Rehnquist, J.) (university's freshman admissions policy violated Equal Protection Clause because its use of race was not narrowly tailored to achieve respondents' asserted compelling state interest in diversity).

5 *See, e.g.,* Richmond v. J.A. Croson Co., 488 U.S. 469, 507, 109 S.Ct. 706 (1989) ((plurality opinion) (minority set-aside program struck down because city failed to demonstrate compelling governmental interest justifying the plan, and plan was not narrowly tailored to remedy effects of prior discrimination.); Adarand Constructors, Inc. v. Peña, 515 U.S. 200, 227, 115 S.Ct. 2097 (1995) (O'Connor, J.) (all racial classifications, imposed by whatever federal, state, or local governmental actor, must be analyzed by reviewing court under strict scrutiny).

6 Rapport au Président de la République, *Redécouvrir le Préambule de la Constitution*, rapport du comité présidé par Simone Veil (La Documentation Framçaise, 2008) (hereinafter "Veil Report.").

7 Regents of the University of California v. Bakke, 438 U.S. 265, 98 S.Ct. 2733, 57 L.Ed.2d 750 (1978).

8 Veil Report at 55, n.4 (citing *Parents Involved in Cmty. Sch.*, 127 S.Ct. at 2738).

8 *Parents Involved in Cmty. Sch.*, 127 S. Ct. at 2768.

9 For example, Article 225-1 of the French penal code defines as discrimination, and prohibits, "all distinctions made among physical persons based on their origin, sex, family status, pregnancy, appearance, name, state of health, disabiity, genetic characteristics, morals, sexual orientation, age, political opinions, union activity, or their membership, or non-membership, real or imagined, in any specific ethnic group, nation, race, or religion." (Unofficial translation).

10 *See* 29 U.S.C. §2000e *et seq.; see also* 42 U.S.C. §1981 (creating a private right of action in Federal court for individuals who claim they have been denied the right to contract based on race).

11 Established by law n° 2004-1486 of December 30, 2004.

12 Statistics available at (www.halde.fr/raport-annuel/2008).

13 Statistics available at (www.eeoc.gov).

14 Reported at www.france-info.com/spip.php?article288122&theme=81&sous_theme=185 (May 5, 2009).

15 Ricci v. DeStefano, -- S. Ct. --, 2009 WL 1835138 (June 29, 2009).

16 Slip op. at 15; *see* Griggs v. Duke Power co., 401 U.S. 424 (1971).

17 Ricci v. DeStefano, 2009 WL 952214 (April 7, 2009) (petitioners reply brief on the merits) at *23-*24.

18 Slip op. at20-21 (Scalia, J., concurring).

19 **Id*. Certainly this is true in the case of the Office of Federal Contract Compliance Programs (OFCCP), which enforces Executive Order 11246 and requires most Federal contractors to submit reports detailing the racial and sexual composition of their workforce. The OFCCP is empowered to punish statistical disparities, which compels employers to make many race-conscious decisions in hiring, promotions, and layoffs.

20 *Id*. at 21.

21 *Id*. at 28 (Ginsburg, J., dissenting).

22 *Id.* at 28 (Ginsburg, J.); 27 (Alito, J.).

23 Justice Ginsburg's dissent in Ricci is consistent with her dissent in

AT&T v. Hulteen, -- S. Ct. --, 2009 WL 1361539 (May 18, 2009) (applying principle of non-retroactivity to hold that the Pregnancy Discrimination Act (PDA) does not compel employers to restore leave credit denied pursuant to a bona fide seniority plan, consistent with existing law when denied, that the PDA would not have allowed to be denied; Justice Ginsburg, joined by Justice Breyer, dissented, and would have required restoration because PDA was meant to erase all vestiges of historical discrimination).

24 Plessy v. Ferguson, 163 U.S. 537, 559, 16 S.Ct. 1138 (1896) (Harlan, J., dissenting) ("Our Constitution is color-blind, and neither knows nor tolerates classes among citizens. In respect of civil rights, all citizens are equal before the law").

25 *Grutter*, 539 U.S. at 341-42 (citing Palmore v. Sidoti, 466 U.S. 429, 432, 104 S.Ct. 1879 (1984)).

26 *Grutter*, 539 U.S. at 342-43 (citations omitted).

27 Northwest Austin Mun. Utility Dist. No. One v. Holder, -- S. Ct. --, 2009 WL 1738345 (June 22, 2009).

28 *Ricci*, slip op. at 21 (Scalia, J., concurring).

Bartlett v. Strickland: Is a Stopping Point Near for Race-Conscious Districting?

*By John J. Park, Jr.**

In *Bartlett v. Strickland*,[1] the U.S. Supreme Court found that there is a stopping point for the influence of race in redistricting. The Court's conclusion that Section 2 of the Voting Rights Act does not require a state to create a so-called "crossover" district in which the minority population is less than 50% of the district's population is, ironically, a victory for federalism. That victory, while substantial, may not be long-lived. In her dissenting opinion, Justice Ginsburg called on Congress "to clarify beyond debate the appropriate reading of Section 2."[2] Congress should decline that invitation because the Court's reading of Section 2 is constitutionally correct and practically sound.

The Court's decision is an ironic victory for federalism because it was a state that lost. That state, North Carolina, was, however, trying to solve a state law problem by arguing for an expansion of the reach of federal law. If the Court had agreed with North Carolina, federal law would have required a substantial, highly intrusive change in the configuration of voting districts throughout the country, at both state and local levels.

The Court's decision is not just a victory for federalism. It stops, for a time at least, the transformation of the Voting Rights Act (VRA). As enacted in 1965, the VRA included provisions that suspended the use of tests or devices as prerequisites for registering to vote in any election in certain jurisdictions and, by use of a formula, identified those jurisdictions.[3] In those jurisdictions, the percentage of African-Americans of voting age who had registered to vote dramatically lagged the percentage of white voters of voting age who were registered, and the difference was attributable to the discriminatory use of tests and devices. With the removal of artificial barriers to registration, the rate of African-American participation in voting has increased dramatically, to the point where, in some of the originally targeted jurisdictions, African-American voters participate at about the same rate as white voters.[4]

The Trajectory of Voting Rights Law

In its one-person, one vote decisions of the 1960's, which were handed down before and after the 1965 enactment of the VRA, the Supreme Court forced a substantial and continuing amount of reapportionment and redistricting. The decisions in *Baker v. Carr*[5] and *Reynolds v. Sims*[6] required the redrawing of legislative districts in Tennessee and Alabama, respectively, which had not been redrawn since 1901. In other decisions, the Court extended the one-person, one-vote principle to congressional districts and to local elected bodies.[7]

Over time,the one-person, one-vote decisions worked with the VRA's elimination of tests and devices to increase African-American participation in the voting process, and that participation led to increased African-American representation in elected bodies. In addition, though, the Court opened the door to further change by grounding the one-person, one-vote principle in the Equal Protection Clause. In *Reynolds*, the Court explained that all the citizens of a state have the right to "full and effective participation" in the state's political processes so that each citizen would have "an equally effective voice in the election of members of his state legislature."[8] "[F]ull and effective participation" has come to mean something different from the unrestricted right to cast a ballot and have it fairly counted. Where once the Act was designed to guarantee the right to vote, its focus has become the vindication of an "effective" vote, and the Act has been transformed from "a universally applicable nondiscrimination norm to a redistributionist program focused on alleviating the disadvantage of designated groups."[9]

Thornburg v. Gingles[10] represents a large step on the way toward the vindication of an "effective" vote. In 1982, Congress amended Section 2 to prohibit not only those voting practices that had been adopted or were maintained with a discriminatory prupose but also those that had a discriminatory result. In *Gingles*, the Supreme Court considered a claim of vote dilution, that is, a claim that the voting power of African-Americans had been diluted by submerging black voters in white majority districts, where they could not win, in the light of the 1982 amendments to Section 2. The Court held that, in order to establish a claim of vote dilution under Section 2, the following "necessary preconditions" had to be met: (1) the minority group has to be 'sufficiently large and geographically compact to constitute a majority in a single-member district;" (2) the minority group has to be "politically cohesive;" and (3) the majority must vote "sufficiently as a bloc to enable it... usually to defeat the minority's preferred candidate."[11]

The Court explained that it did not have to decide what to do when the minority group was "not sufficiently large and compact enough to constitute a majority in a single-member district."[12] It could not, however, escape that question because the trajectory and the associated litigation drove it that way. In the round of redistricting that followed the 1980 census, black majority districts were generally drawn with minority populations well over 50% because of a belief that African-American voters would be slow to participate in elections.[13] With time and increases in the registration and participation rates of African-American voters throughout the South, those "packed" districts could be "cracked" to the point that, while safe minority-majority districts remained, some minority voters, who could be counted on to vote for Democratic candidates, could be put into new districts to increase the chance that Democratic candidates might be elected. Subsequently, in several decisions that followed the post-1990 Census round of redistricting, the Court noted that it had not decided that question and again deferred its consideration.[14] *Bartlett*, thus, represents an end to almost twenty years of deferring the question.

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The Proceedings in North Carolina

Bartlett arose from North Carolina's attempt to redraw House District 18 and the rest of its legislative districts after the 2000 census. HD 18 had been a majority African-American district under the previous plan which was based on the 1990 census, but it could no longer be drawn as a Shaw-compliant geographically compact African-American majority district because of changes in the distribution of the population.[15] Moreover, two decisions of the North Carolina Supreme Court greatly restricted the state's ability to split counties when drawing its new plans. In those decisions, the court held that two sections of the North Carolina Constitution known as the "Whole County Provisions," which taken together provide that "[n]o county shall be divided in the formation" of a state senate or house of representatives district, had to be given effect unless superseded by federal law.[16]

The North Carolina General Assembly decided to split Pender County when it drew HD 18. By itself, Pender County was not populous enough to support its own House District, and neighboring Hanover County had more than enough residents to support two House districts. Rather than keeping Pender County whole, however, the General Assembly split it and combined part of it and part of Hanover County to form HD 18. The African-American voting-age population of the resulting district was 39.96% of the total population.[17]

So drawn, HD 18 is referred to as a "crossover district." Crossover districts fall between majority-minority districts and influence districts. A majority-minority district is, as it says, one in which the minority voting age population is a "numerical, working majority" of the total voting age population in the district.[18] In contrast, while the minority population in a crossover district is less than a majority, that minority population is, "at least potentially, ... large enough to elect the candidate of its choice with help from voters who are members of the majority and who cross over to support the minority's preferred candidate."[19] In practice, given that the African-American community votes overwhelmingly for Democratic candidates, this means adding enough white Democrats to the district to form a Democratic majority. Finally, the minority group in an influence district, even though it is smaller than in a crossover district, can "exert a significant—if not decisive—force in the election process."[20]

Dissatisfied by the results of the redistricting process, Pender County and its five county commissioners, both individually and in their official capacities, filed suit contending that the General Assembly had violated the Whole County Provision by splitting Pender County. In response to that contention, North Carolina's election officials argued that Section 2 of the Voting Rights Act required the creation of a crossover district. Using past election results, they asserted that, in order for there to be an opportunity to elect African-American candidates, the district had to have a total population that was at least 41.54% African-American or a voting age population that was at least 38.37% African-American.[21] With a voting-age population that was 39.96%, HD 18 served as an "effective black voting district."[22]

A three-judge trial court appointed pursuant to state law agreed with the state election officials defending the plan. The court held that the creation of a crossover district like HD 18 was required by Section 2 of the Voting Rights Act. The North Carolina Supreme Court disagreed and reversed the trial court. It relied on, among other things, the

> weight of persuasive authority from the federal circuits, the importance of imposing a practicable rule, the necessity for judicial economy, the redistricting responsibility of the General Assembly, and the inherent tension between the need for majority votes to support the crossover district and the need to find majority bloc voting to conclude that Section 2 does not require the creation of crossover districts.[23]

The Proceedings in the Supreme Court

By its terms, Section 2 prohibits the imposition or enforcement of any "qualification or prerequisite to voting or standard, practice, or procedure... which results in a denial or abridgement of the right of any citizen of the United States to vote on account of race or color...."[24] In order to establish a violation of § 1973(a), one must show, "based on the totality of circumstances," that the members of the protected class "have less opportunity than other members of the electorate to participate in the political processes and to elect representatives of their choice."[25]

Justice Kennedy, joined by Chief Justice Roberts and Justice Alito, concluded that, in order to maintain a claim of vote dilution, the minority group must make up more than 50% of the voting-age population in the proposed district. The notion that Section 2 requires the creation of "effective minority districts' is "contrary to the mandate of Section 2."[26] Justice Kennedy explained, "Section 2 does not impose on those who draw election districts a duty to give minority voters the most potential, or the best potential, to elect a candidate by attracting crossover voters."[27] The African-American voters of HD 18 would have to attract crossover voters because, with only 39.96% of the voting age population, they cannot elect a candidate with their own votes.

In addition, requiring the creation of crossover districts "would create serious tension" with the third *Gingles* criterion.[28] That factor requires a finding that the majority votes "sufficiently as a bloc to enable it... usually to defeat the minority's preferred candidate."[29] Justice Kennedy explained, "It is difficult to see how the majority-bloc-voting requirement could be met in a district where, by definition, white voters join in sufficient numbers with minority voters to elect the minority's preferred candidate."[30] The majority either votes as a bloc, or it does not, and one must presume that it does not when a crossover district is drawn.

Furthermore, requiring that the voting-age population of the minority group be greater than 50% provides benefits for both courts and legislators. The 50% rule provides clear, easily applicable guidance. In contrast, if the drawing of crossover districts were required, courts would be put in "the untenable position of predicting many political variables and tying them to race-based assumptions."[31] In Justice Kennedy's view, "Section 2 allows States to choose their own method of complying with the

Voting Rights Act, and… that may include drawing crossover districts."[32] He cautioned that Section 2 is "not concerned with maximizing minority voting strength...."[33] Accordingly, states can draw crossover districts so long as nothing, including state law, prohibits them and must draw minority-majority districts only when the *Gingles* criteria are met.

Justice Thomas, joined by Justice Scalia, concurred in the judgment. Justice Thomas reiterated his view that "[t]he text of Section 2 of the Voting Rights Act of 1965 does not authorize any vote dilution claim, regardless of the size of the minority population in a given district."[34]

Justice Souter wrote a dissenting opinion in which Justices Stevens, Ginsburg, and Breyer joined. Justices Ginsburg and Breyer also wrote their own dissenting opinions. As noted above, Justice Ginsburg wrote to encourage Congress to overturn the plurality's decision.

The dissenting opinions of Justices Souter and Breyer offer different standards for determining when the drawing of a crossover district would be required. Both base their opinions on the premise that crossover districts can be drawn because majority voters do, in fact, cross over. While Justice Souter disagrees with Justice Kennedy's reading of Section 2 and the Court's precedent, Justice Breyer writes to express his disagreement with the contention that the 50% threshold serves administrative interests. For both, though, the command of Section 2 seems to be that minority voting blocs are entitled, wherever possible, to elect their preferred candidate instead of a consensus candidate who draws support from both majority and minority voters. Section 2 does say "representatives of their choice," but that phrase follows and is, of necessity, limited by the phrase "less opportunity than other members of the electorate" in Section 2. As Justice Kennedy explained, "Section 2 does not guarantee minority voters an electoral advantage. Minority groups in crossover districts cannot form a majority without crossover voters. In those districts minority voters have the same opportunity to elect their candidate as any other political group with the same relative voting strength."[35]

Justice Souter views the question whether the minority population that is less than 50% of the total voting-age population in the district will be large enough to support a crossover district as "a question of fact with an obvious answer...."[36] He acknowledges, though, that "[i]t is of course true that the threshold population sufficient to provide minority voters with an opportunity to elect their candidate of choice is elastic…."[37] Elasticity, which equates to the absence of any clear standard, is not a good reason for "an arbitrary threshold," which might otherwise be called a bright-line rule. Some minority populations are too small to support a crossover district: "No one, for example, would argue based on the record of experience in this case that a district with a 25% black population would meet the first *Gingles* condition."[38] Accordingly, the minimum threshold percentage is a question of fact which, a least for now, would have to have an answer somewhere above 25%.

The elasticity of the required threshold showing does not appear to bother Justice Souter. He asserts that the threshold population needed to support a crossover district will "likely shift in the future" and points to the "packing" and "cracking" of black majority districts.[39] Thus, "racial polarization has declined, and if it continues downward the first *Gingles* condition will get easier to satisfy."[40] While Justice Souter puts a bottom limit to the threshold population, there is plenty of room between his 25% floor and the 39.96% at issue with HD 18 for the required drawing of crossover districts. Furthermore, given the trajectory of redistricting and the related litigation since *Gingles*, including the push for crossover districts, and judiciary's confidence in its ability to resolve the difficult questions presented in the drawing of crossover districts, a holding that Section 2 requires the drawing of crossover districts might well have led, with time, to the mandated drawing of influence districts.[41]

For his part, Justice Breyer suggests that "a reasonably administrable mathematical formula more directly tied to the factors in question" can be found.[42] As an example, he suggests "a numerical ratio that requires the minority voting age population to be twice as large as the majority crossover votes needed to elect the minority's preferred candidate."[43] While Justice Breyer's 2:1 ratio appears to set a floor at about 34% (leaving aside questions about how cohesive the minority community is), Justice Breyer asserts that "most districts where the minority population is below 40% will almost never satisfy the 2:1 rule."[44] He does not claim his 2:1 rule is "perfect," it is just "better" than the alternative: "After all, unlike 50%, a 2:1 ratio (of voting age minority population to necessary non-minority crossover votes) focuses directly upon the problem at hand, better reflects voting realities, and consequently far better separates at the gateway likely sheep from likely goats."[45]

Judicial Rationalism and its Consequences

The dissenting opinions of Justices Souter and Breyer rest on a belief in judicial competence. They are confident that, with the help of litigants and their experts, courts can draw these crossover districts even if they must resolve such issues as the falloff rate of minority voters, the rate and durability of majority crossover voting, the degree to which crossover voting is affected by the identity of the candidates, and other such inherently political issues.[46] That confidence is an example of what Anthony Peacock calls "judicial rationalism." Drawing on the work of Friedrich Hayek, who critiqued the notion that government agencies possess the "moral, social, or political knowledge necessary to regulate social and economic life," Peacock asserts that "what Hayek said about the political branches of government is equally true of the judicial branch."[47]

The dissenters' view, which is yet another iteration of "judicial rationalism," conflicts with the courts' understanding of the role in the redistricting process. In 1975, the Supreme Court reiterated "what has been said on many occasions: reapportionment is primarily the duty and responsibility of the State through its legislative or other body, rather than of a federal court."[48] The lower courts implicitly recognize this; as Justice Kennedy pointed out, none of the courts of appeals had held that Section 2 requires the creation of crossover districts.[49] The lower courts see that they are being asked to do political work that they, almost uniformly, have no desire to do.

The Court's conclusion, which is that Section 2 permits, but does not require, the drawing of crossover districts, favors the work of legislators. That is appropriate given that it is their job to do the political work of redistricting, and they are competent to do it. The plans they enact are frequently attacked by litigants who want something else, and the conclusion that Section 2 requires the creation of crossover districts would give potential litigants another tool to use when attacking a redistricting plan. In 1973, the Court warned that "the goal of fair and effective representation" would not be "furthered' by replacing legislators with "federal courts which themselves must make the political decisions necessary to formulate a plan or accept those made by reapportionment plaintiffs who may have wholly different goals from those embodied in the official plan."[50] The plurality wisely decided not to make a process that is already marked by litigation more so.

Furthermore, the Court's decision marks a stopping point for the consideration of race in redistricting. As Justice Kennedy wrote, a holding that Section 2 requires the creation of crossover districts "would result in a substantial increase in the number of districts drawn with race as 'the predominant factor motivating the legislature's decision.'"[51] Justice Souter disagrees, contending that legislators are likely to draw only majority minority districts unless someone like a court prompted by a litigant can make them draw a crossover district. In his view, crossover districts, which entail the consideration of race, are needed to help states meet their Section 2 obligations "without any reference to race."[52]

That stopping point may not be permanent. Congress is free to follow Justice Ginsburg's suggestion to amend the VRA to require the creation of crossover districts. To do so now would be tone deaf: Section 5 of the VRA just survived a serious constitutional challenge. More important, in 2008, the United States elected Barack Obama President. The time for considering race in election law in the hope that it will become irrelevant may be over. Congress should recognize change when it comes.

Endnotes

1 556 U.S. __, 129 S. Ct. 1231 (2009).

2 129 S. Ct. at 1260 (Ginsburg, J., dissenting). In her view, the "appropriate reading" of Section 2 is that it requires the creation of crossover districts.

3 *See* 42 U.S.C. § 1973b(a). The use of tests or devices was suspended in any jurisdiction that used them and in which less than 50% of the residents of voting age were registered to vote.

4 For example, in Mississippi, the registration rate for African-American voters increased from 6.7% in 1965 to 76.2% in 2004. Furthermore, while the black registration rate trailed the white registration rate by 63.2% in 1964, it exceeded the white registration rate in 2004. The statistics for Alabama and Georgia are similar.

5 369 U.S. 186, 82 S. Ct. 691 (1962).

6 377 U.S. 533, 84 S. Ct. 1362 (1964).

7 In *Wesberry v. Sanders,* 376 U.S. 1, 84 S. Ct. 526 (1964), the Court held that, with respect to congressional districting plans, equal representation meant that districts had to be equally apportioned "as nearly as is practical." Subsequently, in *Karcher v. Daggett,* 462 U.S. 725, 103 S. Ct. 2563 (1983), the Court rejected the notion that, with respect to congressional plans, a de minimis deviation from absolute equality is permitted. As a result, congressional plans are drawn to extraordinarily tight standards.

In *Avery v. Midland County, Tex.,* 390 U.S. 474, 88 S. Ct 1114 (1986), the Court held that one-person, one-vote standards apply to the districts of local governmental bodies. Unlike with congressional redistricting, though, State and local government bodies have some leeway to draw districts that are not equally populated.

8 Reynolds v. Sims, 377 U.S. at 565, 84 S. Ct at 1383.

9 Anthony A. Peacock, Deconstructing the Republic (2008); *see also* George F. Will, *Voting Rights Gone Wrong*, Wash. Post (Mar. 15, 2009), A-19 ("Because of judicial interpretations and legislative amendments, [the Voting Rights Act] now *requires* racial discrimination in the name of *guaranteeing* effective voting by certain preferred minorities (blacks and Hispanics).")(emphasis in original).

10 478 U.S. 30, 106 S. Ct. 2752 (1986).

11 *Id.*, 478 U.S. at 50-51, 106 S. Ct. at 2766-67.

12 *Id.* 478 U.S. at 46, n. 12, 106 S. Ct. at 2764, n. 12.

13 *See, e.g.,* 129 S. Ct. at 1254 (Souter, J., dissenting)(citing Richard Pildes, *Is Voting Rights Law Now at War with Itself? Social Science and Voting Rights in the 2000s*, 80 N.C.L. Rev. 1512, 1527-32 (2002)).

14 *See* Johnson v. De Grandy, 512 U.S. 997, 1008-09, 114 S. Ct. 2647, 2656 (1994); Voinovich v. Quilter, 507 U.S. 146. 154, 113 S. Ct. 1149, 1155 (1993); Growe v. Emison, 507 U.S. 25, 40, n. 5, 113 S. Ct. 1075, 1984, n.5 (1993).

15 In *Shaw v. Reno,* 509 U.S. 630, 113 S. Ct. 2816 (1993), and its progeny, the Supreme Court concluded that the drawing of bizarrely configured districts in order to create black majority districts constituted unconstitutional racial gerrymandering.

16 *See* Stephenson v. Bartlett, 3N.C. 354, 562 S.E.2d 2002); Stephenson v. Bartlett, 357 N.C. 301, 582 S.E.2d 247 (2003).

17 In the plurality opinion, Justice Kennedy notes that, if the North Carolina General Assembly had not split Pender County, the African-American voting-age population of the resulting district would have been 35.3% of the total voting-age population. 129 S. Ct. at 1239.

18 129 S. Ct. at 1242.

19 *Id.*

20 Georgia v. Ashcroft, 530 U.S. 461, 470, 123 S .Ct. 2498, 2506 (2003); *see also* 556 U.S. at ___, 129 S. Ct. at 1242 (In an influence district, the minority population can "influence the outcome of an election even if its preferred candidate cannot be elected.").

21 Pender County v. Bartlett, 649 S.E.2d 364, 367 (2007).

22 *Id.*

23 *Id.* at 506.

24 42 U.S.C. § 1973(a).

25 42 U.S.C. § 1973(b)

26 129 S. Ct. at 1243.

27 *Id.*

28 *Id.* at 1244.

29 Thornburg v. Gingles, 478 U.S. at 51, 106 S. Ct. at 2766-67.

30 129 S. Ct. at 1244.

31 *Id.*

32 *Id.* at 1248.

33 *Id.*

34 *Id.* at 1250. Justice Thomas first expressed that view in his concurring opinion in *Holder v. Hall,* 512 U.S. 874, 891, 114 S. Ct. 2581 (1994)(Thomas, J., concurring).

35 129 S. Ct. at 1246-47.

36 *Id*. at 1250 (Souter, J., dissenting).

37 *Id*. at 1253 (Souter, J., dissenting).

38 *Id*. at 1254 (Souter, J., dissenting).

39 *Id*.

40 *Id*.

41 *But cf.* 129 S. Ct. at 1242 ("The Court has held that §2 does not require the creation of influence districts, [League of United Latin American Citizens v. Perry, 548 U.S. 399, 445-46, 126 S. Ct. 2594, 2525-26 (2006)(Opinion of Kennedy, J.").

42 129 S. Ct. at 1261 (Breyer, J., dissenting).

43 *Id*.

44 *Id*. at 1262.

45 *Id*.

46 *See* 129 S. Ct. at 1244-45 (Justice Kennedy notes that, if courts had to decide when crossover districts are required, they would be placed in the "untenable position of predicting many political variables and tying them to race-based assumptions.").

47 Peacock, *supra* note 9, at 2-3.

48 Chapman v. Meier, 420 U.S.1, 27, 95 S. Ct. 751, 766 (1975); *see also* Gaffney v. Cummings, 412 U.S. 735, 749, 93 S. Ct 2321, 2329 (1973) ("From the very outset, we recognized that the apportionment task... is primarily apolitical and legislative process.").

49 556 U.S at ___, 129 S. Ct. at 1246 (citing cases).

50 Gaffney v. Cummings, 412 U.S. at 749, 93 S. Ct. at 2329.

51 129 S. Ct. at 1247 (quoting Miller v. Johnson, 515 U.S. 900, 916, 115 S. Ct. 2475 (1995).

52 129 S. Ct. at 1258 (Souter, J., dissenting).

Criminal Law and Procedure

What is Private, and What is Protected, in the Privacy Protection Act?

*By Priscilla Adams**

The Privacy Protection Act (PPA) labors under a bit of a misnomer; for what it primarily protects is First Amendment freedom-of-the-press values, not privacy. The PPA is a "gap-filler," enacted to afford "the press and certain other persons not suspected of committing a crime with protections not provided… by the Fourth Amendment."[1] Limited by a few enumerated exceptions, the PPA prohibits a government officer or employee in connection with the investigation or prosecution of a criminal offense from searching for and then seizing work product or documentary materials possessed by a person in connection with a purpose to disseminate information to the public.[2] The Act applies to law enforcement at every level of government and limits the use of search warrants when seeking to obtain evidence from those engaged in First Amendment activities.

Work product is material which is created (either by the possessor or another person) in anticipation of communicating such material to the public. It includes mental impressions, conclusions, opinions, or theories of the person who created, prepared, produced, or authored the material.[3] Documentary material refers to materials upon which information is recorded. It includes written or printed materials, photographs, motion picture films, negatives, video tapes, audio tapes, and other mechanically, magnetically, or electronically recorded cards, tapes, or discs.[4] Specifically excluded from the PPA's protection is contraband (the fruits of a crime or things criminally possessed, or property designed for use, or which is or has been used to commit a criminal offense).[5]

The PPA was passed in 1980, in response to *Zurcher v. Stanford Daily*,[6] in which the Supreme Court held that the First Amendment does not require any special rule limiting the use of warrants to execute a search of the press. *Zurcher* arose from a series of events that began to unfold on April 9, 1971, when officers from the Palo Alto Police Department and the Santa Clara County Sheriff's Department were involved in a violent clash with student protestors occupying Stanford University Hospital's administrative offices. Nine police officers were injured, but they were able to identify only two of their attackers. The student newspaper, the *Stanford Daily* ran a special edition on April 11 devoted to the protest and violence.[7] After the special edition was distributed, police obtained a warrant to search the paper's offices for negatives, film, and pictures depicting the events that occurred at the hospital on April 9. There was never a suggestion by the police that anyone on staff at *Stanford Daily* was involved in the attack. Rather, the warrant claimed the newspaper had evidence relating to the attack on the officers.[8]

Stanford Daily and members of its staff brought a civil rights action against the police officers and other law enforcement officials claiming that the search of the newspaper office was illegal. A federal district court ruled for the newspaper, holding that due to First Amendment considerations, third party searches of newspaper offices are impermissible in all but a very few situations.[9] The court found that the search of the *Stanford Daily* offices was unlawful because (1) it was a third party search of those not suspected of any criminal wrong-doing, and (2) there were no affidavits submitted to the magistrate demonstrating probable cause that the materials would be destroyed or that a subpoena was otherwise impractical.[10] The court of appeals affirmed per curium, adopting the opinion of the district court.[11]

The Supreme Court reversed, holding that the search of *The Daily*'s newsroom was valid and constitutional. The Court explained:

> Under existing law, valid warrants may be issued to search *any* property, whether or not occupied by a third party, at which there is probable cause to believe that fruits, instrumentalities, or evidence of a crime will be found. Nothing on the face of the Amendment suggests that a third-party search warrant should not normally issue.[12]

As to the respondents' argument that searches of newspaper offices for evidence of crime would seriously impede the press in their attempt to acquire, analyze, and disseminate the news, the Court held that neither the Fourth Amendment, nor cases involving First Amendment values, requires any special rule limiting the use of search warrants.[13] The Framers took great care to subjects all searches to the test of reasonableness and to the rule requiring search warrants to be issued by neutral magistrates.[14]

> Properly administered, the preconditions for a warrant—probable cause, specificity with respect to the place to be searched and the things to be seized, and overall reasonableness—should afford sufficient protection against the harms that are assertedly threatened by warrants for searching newspaper offices.[15]

A great deal has changed in the nearly three decades since Congress passed the PPA, nearly four decades since the events unfolded at the *Stanford Daily News* offices. Gone are the days when you had to be Robert Woodward or Carl Bernstein to reach an audience. Today, anyone with access to a computer and an Internet connection can publish her views and opinions via a blog,[16] even if she is not employed as a writer, journalist or reporter. Such information can easily fall within the description of materials afforded protection under the PPA; therefore, it is crucial that law enforcement and others involved in the search and seizure of evidence fully understand the PPA.

The PPA's protection of documents held at a newspaper office that shuns computers in favor of reporters' notebooks and filing cabinets may be straightforward, but this is not always the case when police are executing a warrant for documents maintained on a computer. Computers and other digital devices are capable of storing massive quantities of data as well as a wide

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variety of information; evidence of criminal wrongdoing could co-exist alongside material intended for dissemination to the public. What should an officer do when confronted with the issue of commingled material located in a computer—some of which is protected under the PPA and some which is not? The PPA does not explicitly address the issue of liability for the seizure of communicative material that is technically difficult to separate from evidence seized pursuant to a valid warrant.

The first case that attempted to apply the PPA to electronic publishers was *Steve Jackson Games, Inc. v. U.S. Secret Service*.[17] Steve Jackson Games (SJG) was a small company located in Texas. In addition to producing fantasy role playing games, it ran "Illuminati," an electronic bulletin board system (BBS). The BBS provided its users with a means to send and receive e-mail, published newsletter articles, and generally provided the users with a forum in which they could comment on the games and publications of SJG.[18] The Secret Service was investigating Loyd Blankenship, an employee of SJG who served as a co-SYSOP (system operator) of Illuminati. As a co-SYSOP, Blankenship had the ability to review anything on the BBS, and perhaps the ability to delete anything from the system.[19] Blankenship also operated a bulletin board system out of his home (Phoenix), one of the many systems that distributed "Phrack," an electronic journal that contained a stolen telephone company document.[20]

The Secret Service obtained a warrant to "*search* for and *seize* and thereafter *read* the information stored and contained in computer hardware… and computer software… and written material and documents relating to the use of the computer system… relative to the computer programs and equipment at the business known as Steve Jackson Games…"[21] The agent conducting the seizure was informed by a SJG employee that the company was in the publishing business, but did not grasp the importance of this fact because he was unaware of the PPA.[22] Among the material seized were the draft and backup materials for a book that was intended for immediate publication, drafts of magazines to be published, and the BBS and its contents which included announcements and comments on published articles.[23] SJG, Steve Jackson, and some of the BBS users (none of whom were suspected of any criminal wrongdoing) filed suit against the Secret Service for violation of the PPA and the Electronic Communication Privacy Act,[24] resulting from the seizure of computers, disks, and other materials from SJG.[25]

Finding that work product and documentary material was seized, the court held that the Secret Service's continued seizure and refusal to promptly return the work product material as requested by Steve Jackson and his lawyers constituted a violation of the PPA.[26] The PPA does not address the issue of timing for the return of inadvertently seized PPA material, nor does *Steve Jackson Games* state when the PPA materials should have been returned. However, the court in *Steve Jackson Games* noted that it was months before the majority of the PPA material was returned, even though the agent stated the materials could have been duplicated and returned to SJG in a period of a few hours, or at the most, eight days from the time of the seizure.[27] At the very least, *Steve Jackson Games* seems to direct officers to return inadvertently seized PPA materials as soon as they can.

It is not clear exactly which items led to the violation of the PPA. Was it the seizure of the papers, computers, BBS, or all of these taken together? The court awarded SJG more than $50,000 in expenses and damages for violation of the PPA. The individual users of the BBS were not allowed recovery under the Act, but the court did not address whether this was because they were not considered publishers or because their messages on the BBS did not constitute work product subject to PPA protection.[28]

It is a violation for an officer to search for or seize work product possessed by a person "reasonably believed" to have a purpose to disseminate that material to the public.[29] What exactly constitutes this "reason to believe"? Does this impose a duty to inquire upon agents conducting a search? The language used by the court in *Steve Jackson Games* seems to answer that question in the negative. In that case, the court recognized that the agent failed to make a reasonable investigation of the company, yet still declined to find from a preponderance of evidence that on March 1, 1990, the date on which the search warrant was executed, the agent nor any other employee or agent of the United States had reason to believe that the property seized would include work product of one believed to have a purpose to disseminate such information to the public.[30] However, at some point on March 1, 1990, during the course of the search, the agents were told by a SJG employee that the company was in the publishing business.[31] Because of this, the court found that liability attached on March 2—the time at which the agents knew that SJG was in the publishing business, and that they had seized work product material pursuant to a warrant in violation of the PPA.[32] While not every officer who executes a search warrant will be told by the subject of the search, "we are in the business of disseminating to the public a newspaper, book, or other public communication," an officer must keep in mind that the subject of a search could possess material intended for publication, thus triggering the PPA.

On the other hand, the court in *Lambert v. Polk County, Iowa*,[33] when discussing an entitlement to a preliminary injunction, held that it was improbable that a private citizen would prevail on a claim that officers violated the PPA when they seized a videotape he made that depicted a fatal street fight.[34] The court noted that there was nothing about the way the plaintiff presented himself to the officers that would have led them to reasonably believe that his purpose was to disseminate the tape to the public. He was not an employee of a news station, nor did he tell police that he intended to sell the tape to a news station so it could be disseminated to the public.[35]

The PPA contains exceptions to the general rule that a subpoena must be issued if one wants to obtain work product or documentary materials held by one intending to disseminate the material to the public. A warrant may be used to search for or seize work product if (1) there is probable cause to believe that the person possessing such material has committed or is committing the criminal offense to which the material relates;[36] or (2) there is reason to believe that the immediate seizure of materials is necessary to prevent the death or serious bodily injury of person.[37]

In addition to the criminal suspect and serious bodily injury exceptions, there are two additional exceptions under

which documentary materials may be seized with a warrant. The destruction of evidence exception provides that an officer may search for and seize material relating to a criminal investigation if there is reason to believe that the giving of notice pursuant to a subpoena would result in the destruction, alteration, or concealment of such materials.[38] Finally, a warrant may be used if the materials were not produced in response to a court order mandating compliance with the subpoena, and all appellate remedies have been exhausted; or there is reason to believe that the delay caused by further proceedings would threaten the interests of justice.[39]

The case, *Berglund v. City of Maplewood*,[40] in which plaintiffs brought a claim against the city alleging the warrantless seizure of their videotape violated their rights under the PPA, illustrates two of these exceptions. Plaintiffs Kevin Berglund and Robert Zick wanted to film for their local access television show a banquet being held in honor of departing city council members, but were denied entry due to their refusal to pay the required admission fee. When plaintiffs refused to leave the premises, a confrontation between plaintiffs and the officers ensued. Defendants arrested Berglund and charged him with disorderly conduct, obstructing legal process and obstructing legal process with force. Berglund recorded the altercation on his video camera, which he gave to Zick upon his arrest. Zick refused to give the tape to the police when requested to do so.[41] Police confiscated the videotape, later testifying that they did so because they believed it contained evidence of the crime of disorderly conduct and because they feared the tape would be tampered with if they did not take it.[42] Without even reaching the question as to whether the PPA applied to the material on the tape, the court held that the defendants' actions fit within the criminal suspect and destruction of evidence exceptions provided under the Act.[43]

The criminal suspect exception allows an officer to search for and seize work product or documentary materials if there is probable cause to believe that the person possessing the materials has committed the criminal offense to which the materials relate.[44] The *Berglund* court found the defendants' acts fit squarely within this exception, in that the officers seized the tape from a camera that Berglund had held and operated, and the tape contained evidence of Berglund's disorderly conduct.[45] Furthermore, an objectively reasonable officer would have reason to believe that Zick, who was Berglund's companion, would erase or tamper with the tape that contained evidence of Berglund's conduct; therefore, the destruction of evidence exception also protected the officers' acts.[46]

In *Guest v. Leis,*[47] an online BBS was seized pursuant to a valid warrant in an obscenity investigation. Subscribers to the BBS received passwords that enabled them to e-mail and take part in chat room conversations, on-line games, and conferences. Users were also able to download computer programs, pictures, and other files. The users of the BBS and the BBS operator brought suit against the sheriff, his department, and deputies, claiming that these defendants violated the PPA by seizing materials intended for publication.[48] Although not clear as to what constituted the PPA-protected material, the court assumed that PPA-protected material was on the system.[49] Defendants claimed that whereas the operator of the bulletin board had standing to bring suit as the possessor of the information at issue, the users of that system did not.

This case underscores one of the differences between information stored in a digital form, for example on a computer server or BBS, and that which is tangible property held in an actual physical location. Defendants relied on *Powell v. Tordoff*[50] to support their claim that a plaintiff must be in actual possession of physical materials in order to have standing to bring a claim under the PPA.[51] In *Tordoff,* DePugh was the former owner of a building that was being leased by Powell. The building was searched and property seized pursuant to a search warrant. The court dismissed DePugh's PPA claim for lack of standing, noting that the property seized was in the *possession* of Powell, and it was "the goal of the statute to protect innocent third parties in possession of documents and papers from governmental intrusions which would unnecessarily subject their files and papers to search and seizure."[52] In *Leis*, however, the Sixth Circuit dismissed this argument noting that § 2000aa-6(a) of the PPA creates a cause of action for any "aggrieved person"[53] and the plaintiffs were aggrieved by the seizure of their communications.[54]

The *Leis* court noted that interpretation of the Act presents challenges unforeseen by the drafters—that of a computer search[55] and the issue of liability for the seizure of PPA-protected material when it occurs *incidentally* to the seizure of evidence pursuant to a valid warrant. Referencing its earlier discussion of the Fourth Amendment claims, the court noted it is unreasonable to require police to sort through extensive computer files in a suspect's office in order to separate out files not covered by the search warrant.[56] In light of the technical difficulties associated with the search of computers, the court held it was reasonable for the police to seize the computers and their contents in order to find the files specified in the warrant.[57] Furthermore, there was no liability under the PPA for the seizure of PPA-protected material that was commingled with the non-PPA protected obscenity,[58] based on the criminal suspect exception.[59] The court emphasized that police who *seize* PPA-protected materials commingled on a criminal suspect's computer may not then *search* the protected materials.[60] The Sixth Circuit distinguished the case from *Steve Jackson Games* in which the court awarded PPA damages to the company, but not the bulletin board subscribers. In *Steve Jackson Games* the owner of the computers was not a criminal suspect, and furthermore, the agents read the protected material, a fact which the plaintiffs at the case at bar was unable to prove.[61]

Six years after deciding *Leis*, the Sixth Circuit decided *S.H.A.R.K. v. Metro Parks Serving Summit County*,[62] in which an animal rights organization claimed the park district violated the PPA by seizing cameras the group surreptitiously placed in the park in an attempt to tape a deer-culling operation.[63] The district court held that there was not a search or a seizure as envisioned by the PPA, in that the rangers happened to see and subsequently remove the cameras while they were engaged in normal operations, not in connection with the investigation or prosecution of a criminal offense. While acknowledging that the plaintiffs were charged with criminal trespass, the court noted that these charges were brought *after* the cameras were discovered, so the cameras could not have been seized in

connection with an investigation into the trespass.[64] The Sixth Circuit disagreed with the district court's analysis, finding that there was an issue of fact as to whether the confiscation of the cameras constituted a seizure under the PPA, agreeing with the plaintiffs that a fact-finder could determine that the defendants began a criminal investigation as soon as they discovered the first camera.[65] However, even if the plaintiffs were correct and the PPA was applicable, the Sixth Circuit stated that this disputed fact was not material, since the plaintiffs would be barred from relief under the Act's suspect exception.[66]

It is interesting to note the language used by the Sixth Circuit when discussing the criminal suspect exception to the PPA. In *Leis*, the court speaks of "innocent material" which might be present on a computer along with evidence of a crime,[67] stating that the PPA does not prohibit police from searching and seizing evidence on a computer merely because the computer also contains "innocent" (or PPA-protected) materials. A contrary holding, the court reasoned, would enable criminals to safeguard their criminal records or evidence by storing them in a computer on which they have also stored work product or documentary materials.[68] Presumably, the converse would also be true: work product or documentary material does not lose the protections afforded by the PPA simply because it is located on the computer of a criminal suspect, since by definition, it would not relate to the crime for which he is suspected.

In *S.H.A.R.K.*, the Sixth Circuit refers not to *innocent material*, but *innocent third parties*, noting that "[t]he goal of the [PPA] is to protect innocent third parties in possession of documents and papers from governmental intrusions which would unnecessarily subject their files and papers to search and seizure. Consequently, it is these persons who may avail themselves of the remedy provided by the statute."[69] The *S.H.A.R.K.* court found there were no "innocent third parties" whose rights were violated by the governmental investigation and search; the target of the investigation and the party subject to the search and seizure were one and the same.[70] Accordingly, the court concluded that the plaintiffs were not entitled to protection by the PPA against the seizure that occurred.

The PPA does not use the language "innocent third party" in setting forth from whom the government shall not seize work product or documentary material.

> Notwithstanding any other law, it shall be unlawful for a government officer or employee, in connection with the investigation or prosecution of a criminal offense, to search for or seize any work product materials possessed by a person reasonably believed to have a purpose to disseminate to the public a newspaper, book, broadcast, or other similar form of public communication, in or affecting interstate or foreign commerce.[71]

A civil cause of action for damages, costs, and attorneys' fees is the exclusive remedy available to one who is aggrieved by a search or seizure in violation of the Act;[72] violations of the PPA will not lead to suppression of evidence.[73] Assuming that a party has a claim for damages under the PPA, against whom can he bring a suit? Liability under the PPA attaches to those who search for or seize the work product material, that is, those who conduct the search. Therefore, a district attorney who reviews a warrant application but otherwise does not engage in conduct that could be viewed as assisting in the execution of the warrant will not be liable under the PPA.[74] If the violation is committed by federal or local officials the action would be against the United States or the local government, respectively.[75] The PPA does not authorize suits against municipal officers or employees in their individual capacities.[76]

The Eleventh Amendment provides that a citizen may not bring a suit for monetary damages against a state in federal court,[77] unless the state expressly waives its immunity and agrees to be sued, or Congress statutorily abrogated immunity by clear and unmistakable language.[78] The PPA does not abrogate Eleventh Amendment immunity of the states, but rather provides for liability of state officers or employees as individuals if a state declines to waive such immunity.[79] A state officer's or employee's reasonable good faith belief in the lawfulness of his conduct is a complete defense where the state has not waived its Eleventh Amendment immunity.[80] A government or governmental unit, however, may not assert this defense on its behalf.[81]

What do these cases tell us? What is it, exactly, that the PPA protects—innocent parties or innocent materials? *Leis* points to the latter: just as evidence of a crime located on a criminal suspect's computer does not *gain* status as PPA-protected material due to the presence of work product or documentary material, the presence of criminal evidence will not strip the protections of the PPA from the "innocent material."

The Sixth Circuit in *Leis* notes the difficulty in applying the PPA to cases involving searches of computers, stating that "[t]he PPA does not explicitly address the question of liability for a seizure of communicative material that is technically difficult to separate from the evidence of a crime whose seizure is authorized by a valid warrant."[82] While it may be impossible to avoid the seizure of PPA-protected material in the context of a computer search, *Leis* makes it clear that the materials may not be searched. Therefore, government agents who conduct searches of computers or other digital devices must be aware of the prohibitions of the PPA, and recognize when the Act is triggered. Unfortunately, *Leis* fails to provide guidelines or procedures that the government should follow in dealing with the seized PPA-protected material. The Sixth Circuit's reference to "innocent third parties" in *S.H.A.R.K.* can be reconciled with analysis since the material seized and subsequently searched in *S.H.A.R.K.* related solely to the plaintiffs' alleged criminal offense of trespass.

Endnotes

1 S. Rep. No. 96-874 at 4 (1980), *reprinted in* 1980 U.S.C.C.A.N. 3950.

2 Privacy Protection Act, 42 U.S.C. § 2000aa (1980).

3 *Id.* at § 2000aa-7(b) (1)-(3).

4 *Id.* at § 2000aa-7(a).

5 *Id.* at § 2000aa-7(a) & (b).

6 Zurcher v. Stanford Daily, 536 U.S. 547 (1978).

7 *Id.* at 550-551.

8 *Id.*

9 Stanford Daily v. Zurcher, 353 F. Supp 124, 135 (N.D. Cal. 1972).

10 *Id.*

11 Stanford Daily v. Zurcher, 550 F.2d 464 (9th Cir. 1977).

12 Zurcher v. Stanford Daily, 536 U.S. 554.

13 *Id.* at 565.

14 *Id.*

15 *Id.* at 565.

16 A blog is a type of website, usually maintained by an individual, in which he or she regularly posts entries of commentary. Blogs may also contain video and graphics. Many blogs provide information on a particular subject, while others serve more as an on-line diary for its creator. http://en.wikipedia.org/wiki/Blog (last accessed Apr. 13, 2009).

17 Steve Jackson Games v. U.S. Secret Service, 816 F. Supp. 432 (W.D. Tex. 1993).

18 *Id.* at 440.

19 *Id.* at 435.

20 *Id.*

21 *Id.* at 439.

22 *Id.* at 437.

23 *Id.* at 439-440.

24 18 U.S.C. §§ 2703, 2711 (1986).

25 *Steve Jackson Games, supra* note 17, at 432, 434-35.

26 *Id.* at 440-41.

27 *Id.* at 437.

28 *Id.* at 441.

29 42 U.S.C. § 2000aa(a).

30 *Steve Jackson Games, supra* note 17, at 440.

31 *Id.* at 437.

32 *Id.* at 438.

33 Lambert v. Polk City, Iowa, 723 F. Supp. 128 (S.D. Iowa 1989).

34 *Id.* at 132.

35 *Id.*

36 42 U.S.C. § 2000aa(a)(1).

37 *Id.* at § 2000aa(a)(2).

38 *Id.* at § 2000aa-6(b)(3).

39 *Id.* at § 2000aa(b).

40 Berglund v. City of Maplewood, 173 F. Supp. 2d 935 (D. Minn. 2001).

41 *Id.* at 940-41.

42 *Id.* at 941.

43 *Id.* at 949-50.

44 *Id.* at 949 (citing 42 U.S.C. § 2000aa(a)(1) & (b)(1)).

45 *Berglund*, 173 F. Supp. 2d.at 949.

46 *Id.* (citing 42 U.S.C. § 2000aa(b)(3)).

47 Guest v. Leis, 255 F.3d 325 (6th Cir. 2001).

48 *Id.* at 340.

49 *Id.* at 342.

50 Powell v. Tordoff, 911 F. Supp. 1184 (N.D. Iowa 1995).

51 *Id.* at 1189-90.

52 *Id.* at 1190.

53 *Leis*, 255 F.3d at 341(citing 18 U.S.C. § 2510(11)) (defining aggrieved person under ECPA Title I as one who was a party to any intercepted wire, oral, or electronic communication or against whom an interception was directed).

54 *Leis*, *supra* note 47, at 341.

55 *Id.*

56 *Id.* at 341, 334-35.

57 *Id.* at 335.

58 *Id.* at 342.

59 The "suspect exception" provides:

> [T]his provision [barring search and seizure of work product materials] shall not impair or affect the ability of any government officer or employee, pursuant to otherwise applicable law, to search for or seize such materials, if –(1) there is probable cause to believe that the person possessing such materials has committed or is committing the offense to which the materials relate: Provided, however [t]hat a government officer or employee may not search for or seize such materials under the provisions of this paragraph if the offense to which the materials relate consists of the receipt, possession, communication, or withholding of such materials or the information contained therein (but such a search or seizure may be conducted under the provisions of this paragraph if the offense consists of the receipt, possession, or communication of information relating to the national defense, classified information, or restricted data under the provisions of [certain federal laws], or if the offense involves the production, possession, receipt, mailing, sale, distribution, shipment, or transportation of child pornography, the sexual exploitation of children, or the sale or purchase of children under section 2251, 2251A, 2252, or 2252A of Title 18…

42 U.S.C. § 2000aa(a).

60 *Leis*, 255 F.3d at 342.

61 *Id.* at 342, n.12.

62 S.H.A.R.K. v. Metro Parks Serving Summit County, 449 F.3d 553 (6th Cir. 2007).

63 *Id.* at 566.

64 *Id.*

65 *Id.*

66 *Id.*

67 *Leis, supra* note 47, at 325, 342.

68 *Id.*

69 *S.H.A.R.K.*, 499 F.3d at 567 (citing S. Rep. No. 96-874, at 15 (1980), *reprinted in* 1980 U.S.C.C.A.N. 3950, 3961).

70 *S.H.A.R.K.*, 499 F.3d at 567.

71 42 U.S.C. § 2000aa(a).

72 *Id.* at § 2000aa-6(d), (f).

73 *Id.* at § 2000aa-6(e).

74 Mink v. Suthers, 482 F.3d 1244, 1258 (8th Cir. 2007), Citicasters v. McCaskill, 89 F.3d 1350, 1356 (8th Cir. 1996).

75 42 U.S.C. § 2000aa-6(a)(1).

76 Davis v. Gracey, 111 F.3d 1472, 1482 (10th Cir. 1997) (PPA claim against municipal officers in their individual capacities dismissed for lack of subject-matter jurisdiction).

77 Welch v. Texas Dep't of Hwys. & Public Transp., 483 U.S. 468, 472 (1987), Barnes v. State of Mo., 960 F.2d 63, 64 (8th Cir. 1992).

78 Barnes v. State of Mo., 960 F.2d at 65.

79 *Id.* at 63, 64.

80 42 U.S.C. § 2000aa-6(b).

81 *Id.* at § 2000aa-6(c).

82 *Leis*, *supra* note 47, at 325, 342.

Environmental Law & Property Rights

Point-Counterpoint: Repairing the Clean Water Act

Brent A. Fewell & James Murphy

The authors wish to dedicate this debate to the late Jim Range, one of the nation's most prominent advocates for natural resource conservation and a tireless proponent of clear air and water. Jim died in January 2009 after a courageous battle with kidney cancer. His cumulative influence on the modern-day conservation movement is inestimable and he leaves behind a legacy that will be experienced and lived by the public for decades and centuries to come. He was a rare breed in Washington, putting aside party politics and working in a bipartisan fashion to achieve what he believed was in the best interest of the public and the environment. Those of us who knew him were lucky and understand his enormous contributions. Those who did not have the privilege of knowing or working with Jim can get to know him and his amazing legacy better at www.jimrange.com.

Currently, the Federal Water Pollution Control Act (hereinafter referred to as the "Clean Water Act") protects "navigable waters" defined as "waters of the United States."[1] For most of the Act's history, the term "waters of the United States" has been broadly construed to mean virtually all surface waters, the regulation of such waters being necessary to fulfill the Act's objective to "restore and maintain the chemical, physical, and biological integrity of the Nation's waters."[2] However, two recent Supreme Court decisions, *Solid Waste Agency of Northern Cook County (SWANCC) v. Army Corps of Engineers*[3] and *Rapanos v. United States*,[4] placed limits on the scope of the Act's jurisdictional reach, especially as it relates to isolated water bodies and those not having a significant connection to navigable waters.

In response, Congress has introduced the Clean Water Restoration Act (hereinafter referred to as the "Restoration Act"). Sponsors and proponents of the Restoration Act argue that it would restore the pre-*SWANCC* scope of CWA protections by removing the term "navigable" from the Act, defining the term "waters of the United States" in a manner consistent with the long-standing regulatory scope of the Act, and issuing findings that support Congress's constitutional authority to regulate such waters. The Restoration Act was introduced in previous Congresses in both the House[5] and the Senate, and currently it has been introduced in the Senate,[6] with a House bill expected soon.

[*The authors' analysis in this debate is based on the Clean Water Restoration Act as originally introduced in the House in the 110th Congress, which is substantially identical to the Act as introduced in the Senate in the 111th Congress in S. 787. Subsequent to the authors' drafting of this article, S. 787 passed out of the Senate Environment and Public Works Committee with certain changes on June 18, 2009. The phrase "to the maximum extent those waters, or activities affecting those waters, are subject to the legislative power of Congress under the Constitution" was removed from the definition section of the bill. Additionally, a "Rules of Construction" section was added that states the term "waters of the United States" shall be construed consistently with "the scope of Federal jurisdiction under th[e Clean Water] Act, as interpreted and applied by the Environmental Protection Agency and the Corps of Engineers prior to January 9, 2001 (including pursuant to the final rules and preambles published at 53 Fed. Reg. 20764 (June 6, 1988) and 51 Fed. Reg. 41206 (November 13, 1986); and... the legislative authority of Congress under the Constitution." The regulatory exemptions for prior converted cropland and waste treatment systems were also added to the definition section. Minor changes to the findings were made as well.*]

The stated purposes of the Act are as follows:

- to reaffirm the original intent of Congress in enacting the Clean Water Act of 1972 to restore and maintain the chemical, physical, and biological integrity of the waters of the United States;
- to clearly define the waters of the United States that are subject to the Act;
- to provide protection to the waters of the United States to the fullest extent of the legislative authority of Congress under the Constitution.

Critics of *SWANCC* and *Rapanos* argue that through these decisions the Supreme Court has limited and confused the scope of the federal government's authority to regulate waters of the United States, including non-navigable waters far upstream or remote from traditionally navigable waters. Others, however, contend that the Supreme Court's decisions reflect a reasonable interpretation of the Act and the limited scope of federal authority there under.

While proponents of the Restoration Action argue that legislation is needed to fix the problems caused by *SWANCC* and *Rapanos*, opponents question whether the federal government's authority should extend to regulating both interstate and intrastate waters. The following debate sets forth arguments for and against the Restoration Act and the significance of expanding federal authority in this area.

Specifically, this article addresses three key questions concerning the Restoration Act: (1) what would be the effect of deleting the term "navigable" from the Act; (2) would the Restoration Act withstand constitutional challenge; and (3) what effect would the Restoration Act have on the respective roles of the federal and state governments in managing water resources? This article will answer these questions in turn.

The Federalist Society: The CWRA proposes to delete the term "navigable" from the term "navigable waters of United States." What effect do you believe this amendment would have on federal jurisdiction?

Mr. Fewell: Let me begin by underscoring the environmental and legal significance of this issue. From my perspective, the starting point for this debate does not begin with the question of whether certain non-navigable waters, such as adjacent or isolated wetlands, or ephemeral or intermittent streams, are environmentally or ecologically important. These resources unquestionably provide a variety of environmental benefits, including wildlife habitat, groundwater recharge, water quality filtering, and flood protection that are beneficial. Many such waters are valuable and indeed worth protecting. The question is not whether they are important or should be protected, but rather protected by what means, by whom, and at what cost? It is the costs associated with the Restoration Act that I fear most, including the costs on state sovereignty and the further erosion of the rights of property owners and individual liberties.

At a point in American history already marked with unprecedented expansion of federal power, the Restoration Act, if enacted, would mark one of the most significant expansions of federal authority over private property and how property is used. The effect of the Restoration Act would grant new, sweeping federal authority over not only *all interstate and intrastate waters* but *all activities affecting* such waters. Thus, it represents an extension of both geographic- and activity-based authority, which would vastly expand federal regulation over all land use activities. If the Restoration Act were adopted, there would be few, if any, places or private activities that the federal government's authority could not and would not reach. Unfortunately, as drafted, the Restoration Act seems more intent on regulating land use than protecting water quality.

The Restoration Acts explicitly seeks to expand the federal government's power to the "fullest extent of the legislative authority of the Congress under the Constitution" invoking not only the Commerce Clause but the Necessary and Proper Clause and the Treaty Clause to protect species of fish, birds, and wildlife. Such expansion of authority beyond Congress's commerce power authority raises serious questions regarding the outer limits of Congress's constitutional authority—questions for which there are no clear answers.

Like veins and capillaries running through the human body, the vast network of rivers, tributaries, streams, and ditches in America reach deep across the country, into every state, region, local community and private property. As certain as gravity's effect, rain falls to the earth and either fills isolated depressions, percolates into the earth as groundwater, or flows downhill through ditches and drainages into ever larger streams, ponds, rivers, lakes and, in some cases, eventually to the ocean. Runoff that flows downhill invariably carves rills and ditches into the landscape that may or may not lead to navigable waters. Such ditches may be located in the headwaters, situated many tens or hundreds of miles away from the nearest downstream navigable water with little, if any, connection.

The landscape is dominated with manmade lakes, ponds, drainages, and ditches that are created for a number of commercial and non-commercial reasons. For example, roadside ditches and drainages are mandatory in most cases and designed to shed and move water away from the driving surface for safety reasons. These ditches and drainages, along with any other drainage or water feature, no matter how commercially or environmentally significant or insignificant, would be subject to federal jurisdiction under the Restoration Act.

While many of our nation's water bodies are navigable many are not. In fact, many streams and wetlands located in the headwaters of watersheds are not navigable in fact, have no significant connection to navigable waters, and are incapable of supporting commercial activity. Therefore, the Restoration Act raises several very important questions. What constitutes a "water of the United States"? Is it any water body, ditch, drainage, or erosion feature, regardless of how much or how long water is present or whether there is any meaningful nexus to navigable waters or commercial activities? Second, does the federal government have constitutional authority to regulate all waters, whether or not they are capable of supporting commerce or have a nexus to navigable waters? Third, should the federal government's authority extend to regulating any water body or activity that affects a water body that provides ecological benefits, such as wildlife habitat for migratory birds, fish, frogs, or salamanders? Will the Act merely become another habitat protection mandate from Congress?

To date the federal government's authority to regulate water bodies has been tethered to the concept of "navigability" and the Commerce Clause. The term "navigable" has been a part of the Act's lexicon since 1972 and, in fact, Congress used the term a total of 81 times in the legislation. The Restoration Act seeks to remove this term from the statute.

In 1972, when the Act was passed, Congress aspired to "restor[e] and maintain[] the chemical, physical, and biological integrity of [the] Nation's waters" by, among other things, "eliminating the discharge of pollutants into the navigable waters" by 1985.[7] And while Congress no doubt intended the Act to be used to clean up and safeguard the nation's waters, it likewise intended to erect some limits on the scope of the federal government's authority by the use of the term "navigability." Moreover, the clear object of the Act was to protect the chemical, physical and biological integrity of the nation's waters. Congress's object was not to protect every water body, nor to protect wildlife habitat *per se*.

The Supreme Court's decisions in both the *SWANCC* and *Rapanos* found that the federal government's authority under the Clean Water Act is deeply rooted in Congress's Commerce Clause power. For years, the EPA and the Corps of Engineers unlawfully applied the Migratory Bird Rule, which allowed the government to assert jurisdiction over non-navigable, isolated water bodies based solely on the fact that such waters provided habitat for migratory birds and endangered species. The Supreme Court in *SWANCC* rightly concluded that the Migratory Bird Rule simply went too far, and the history of the Act did not support such a broad interpretation of Congress's authority under its commerce power.

Even after *SWANCC*, the federal government asserted jurisdiction over non-navigable tributaries and ditches many miles removed from navigable waters and with no connection to water-borne commerce. Yet again, the Court in *Rapanos* concluded that the federal government had overreached

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its authority under the Act. Both the plurality and Justice Kennedy's concurring opinion in *Rapanos* start from a common understanding that the term "navigable waters" under the Act is deeply rooted in the concept of traditional navigable waters as that term is used under the Rivers and Harbors Act, waters which are navigable-in-fact (or reasonably susceptible to being made so) for purposes of a water-borne highway for the transport of goods in interstate commerce.[8] The *Rapanos* Court further recognized, however, that the meaning of "navigable waters" in the Act, although broader than the traditional understanding of navigable waters (and reaching, for example, non-navigable wetlands adjacent to navigable waters), must still be given some importance and limits. The importance according to Justice Kennedy is the presence of a "significant nexus" between the waters at issue and traditional navigable waters.

Proponents of the Restoration Act argue that the "significant nexus" standard is confusing and unworkable and fails to protect certain waters previously subject to federal jurisdiction, i.e., those without a significant nexus, such as ditches and ephemeral streams with little or no flow most of the year. Admittedly, determining the presence of a "significant nexus" has required additional agency resources and created a fair amount of confusion.

However, the Restoration Act goes far beyond "fixing" the confusion caused by *Rapanos* and *SWANCC* in that, if adopted, it would significantly expand federal authority to waters and activities affecting such waters never before subject to federal regulation. Prior to *SWANCC*, not all intrastate waters and activities affecting such waters were subjected to federal jurisdiction. Thus, the argument that the Restoration Act would merely turn the clock back to pre-*SWANCC* times is untenable.

All activities affecting the landscape, whether constructing a new home, road, or school, will invariably alter the movement of rainfall and have some affect on water, de minimis or otherwise. Consequently, all such activities would be subject to federal regulation under the Restoration Act, which makes no distinction between commercial, environmental, or ecological value of various waters or the significance of adverse impacts from activities affecting such waters. As such, it is virtually impossible to conceive of any land-disturbing activity that would not be subject to federal regulation under the Restoration Act.

Mr. Murphy: The Restoration Act seeks to restore the CWA's historical scope of protections by, in part, removing the confounding term "navigable" from the Act. Removal of the term "navigable" from the Act would have the effect of removing the confusion caused by *SWANCC* and *Rapanos* and firmly restore the historic scope of the Act's jurisdiction which existed prior to the Supreme Court's decision in *SWANCC*.

The Clean Water Act's purpose, history, and structure make clear that it is concerned with protecting the quality of our nation's waters, not protecting navigation. In light of *SWANCC* and *Rapanos*, removal of the term "navigable" is necessary to make clear Congress' original intent, and to restore full protections to our nation's waters.

The legislative history of the Act provides powerful statements demonstrating that by defining "navigable waters" as "waters of the United States," Congress intended to broadly protect waters well beyond any traditional concept of navigability. For instance, the 1972 Conference Report states that, "The conferees fully intend that the term 'navigable waters' be given the broadest possible constitutional interpretation unencumbered by agency determinations which have been made or may be made for administrative purposes."[6] A 1972 floor statement by Representative John Dingell, a chief architect of the Act, further describes this intent: "[The] conference bill defines the term 'navigable waters' broadly for water quality purposes. It means all 'the waters of the United States' in a geographical sense."[7] When an attempt to narrow the Act's scope of protection was ultimately defeated in 1977, Senator Howard Baker reiterated this broad intent, noting that "once seemingly separate types of aquatic systems are, we now know, interrelated and interdependent. We cannot expect to preserve the remaining qualities of our water resources without providing appropriate protection for the entire resource."[8]

As such, until *SWANCC* the term "navigable" was given little notice by the courts. The Supreme Court in *United States v. Riverside Bayview Homes* found that "the Act's definition of 'navigable waters' as 'the waters of the United States' makes it clear that the term 'navigable' as used in the Act is of limited import. In adopting this definition of 'navigable waters,' Congress evidently intended to repudiate limits that had been placed on federal regulation by earlier water pollution control statutes and to exercise its powers under the Commerce Clause to regulate at least some waters that would not be deemed 'navigable' under the classical understanding of that term."[9] Similarly, in *International Paper v. Ouellette*, the Supreme Court found that the Act "applies to... virtually all bodies of water."[10]

Other courts have similarly found Congress' intent to be broad. For instance, in one of the first major cases to consider the issue, *Natural Resources Defense Council v. Callaway*, the District of Columbia Federal District Court found that

> Congress by defining the term 'navigable waters' in Section 502(7) of the Federal Water Pollution Control Act Amendments of 1972... to mean 'the waters of the United States, including the territorial seas,' asserted federal jurisdiction over the nation's waters to the maximum extent permissible under the Commerce Clause of the Constitution. Accordingly, as used in the Water Act, the term is not limited to the traditional tests of navigability. [11]

Another early case, *United States v. Ashland Oil and Transportation Co.*, found that "Congress' clear intention as revealed in the Act itself was to effect marked improvement in the quality of the total water resources of the United States, regardless of whether that water was at the point of pollution part of a navigable stream."[12] In support of this conclusion, the Court relied on the legislative history of the Act:

> [T]he conference bill defines the term "navigable waters" broadly for water quality purposes. It means all "the waters of the United

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> States" in a geographical sense. It does not mean "navigable waters of the United States" in the technical sense as we sometimes see in some laws.... Thus, this new definition clearly encompasses all water bodies, including main streams and their tributaries, for water quality purposes. No longer are the old, narrow definitions of navigability, as determined by the Corps of Engineers, going to govern matters covered by this bill.[13]

The *Ashland Oil* Court went on to reach the obvious conclusion that:

> Congress knew exactly what it was doing and that it intended the Federal Water Pollution Control Act to apply, as Congressman Dingell put it, "to all water bodies, including main streams and their tributaries." Certainly the Congressional language must be read to apply to our instant case involving pollution of one of the tributaries of a navigable river. Any other reading would violate the specific language of the definition [of navigable waters as waters of the United States] and turn a great legislative enactment into a meaningless jumble of words.[14]

It is only in its most recent opinions that the Supreme Court indicated a need for some demonstrated linkage to traditionally navigable water bodies for a water way to be protected. In *SWANCC*, the Supreme Court ruled that "[t]he term 'navigable' has at least the import of showing us what Congress had in mind as its authority for enacting the CWA: its traditional jurisdiction over waters that were or had been navigable in fact or which could reasonably be so made."[15] In *Rapanos*, while the Supreme Court failed to reach any majority consensus on what constitutes a "navigable water" for purposes of the Act, four Justices in a plurality opinion commented that "the Act's use of the traditional phrase 'navigable waters'... further confirms that it confers jurisdiction only over relatively *permanent* bodies of water."[16] In a solo concurring opinion, a fifth Justice, Anthony Kennedy, stated that, "Consistent with... the need to give the term 'navigable' some meaning, the Corps' jurisdiction over wetlands depends upon the existence of a significant nexus between the wetlands in question and navigable waters in the traditional sense."[17]

Contrary to the water quality protection goals of the Act, the undue weight *SWANCC* and *Rapanos* have placed on the linkage between upstream waters and navigable waters in order to establish the Act's jurisdiction has proved confusing, administratively unworkable and has had the affect of making it harder or near impossible to protect a troubling number of water resources.

The resulting confusing has been disastrous. A circuit split has already developed regarding the application of the fractured *Rapanos* opinion, with courts disagreeing on the basic question of which *Rapanos* test applies.[18] Even if the question of which of the tests to apply can be worked out, it is unclear precisely what is required to assert jurisdiction under either test and which waters require the application of a case-by-case jurisdictional test.

As a result, both administrative and enforcement efforts under the Act have been greatly hindered. According to an EPA memo and a December 2008 Congressional memo, approximately 500 enforcement cases have either been shelved or hampered by the current legal confusion.[19] The 2008 Congressional memo described "overwhelming" stress levels and "plummeting" morale among U.S. Army Corps of Engineers and EPA workers assigned with administering the Act.[20] In appealing unsuccessfully to the Supreme Court for certiorari review of a recent Eleventh Circuit case that required the government to retry a criminal case involving the knowing discharge of industrial pollutants into a perennial stream, the Office of Solicitor General stated that having to apply the cumbersome Justice Kennedy test to all jurisdictional determinations in the states of the Eleventh Circuit would have added over 28,000 additional person hours of work time over the previous year.[21] And, most importantly, countless waters are not being protected, including wetlands vital to flood control, groundwater recharge, and habitat provision, and many streams that provide clean water and drinking supplies. Indeed, EPA estimates that approximately a third of the Nation's population rely in part on now at-risk streams for their drinking water.[22]

Simply put, the Act is currently broken. Removing the term "navigable" from the Act is a necessary step to make clear Congress's original intent to broadly protect all "waters of the United States." Removing the term "navigable" from the statute is critical in order to affirm the Act's purpose to "restore and maintain the chemical, physical, and biological integrity of the Nation's waters," rather than regulate navigation; restore the accepted pre-*SWANCC* jurisdictional scope without the clouds of confusion created by *SWANCC* and *Rapanos*; and enable the Act to properly function for the benefit of the environment, the regulated community, those charged with administering the Act, and the general public. Failure to remove this term will simply result in further legal wrangling and attempts to discern a jurisdictional limit that is incongruent with the purpose of the Act and the ecological realities that govern water resources.

The Federalist Society: Do you believe the CWRA, if adopted, would withstand constitutional challenge?

Mr. Fewell: The Constitution does not give Congress authority to regulate something simply because it wants to or because to do so would produce environmentally beneficial results. This debate must first be framed by the principle that the Constitution created a federal government of enumerated powers, not unlimited powers.[9] As James Madison wrote, "[t]he powers delegated by the proposed Constitution to the federal government are few and defined. Those which are to remain in the State governments are numerous and indefinite."[10] Thus, there are certain limits on Congress's power and its ability to regulate.

As reminded by the Supreme Court in *U.S. v. Lopez,*[11] Congress's power to regulate *vis-a-vis* its interstate commerce power is not unbounded and has outer limits. The Supreme Court previously has warned against the dangers occasioned by ever expanding federal authority, which "must be considered in the light of our dual system of government and may not be extended so as to embrace effects upon interstate commerce so indirect and remote that to embrace them, in view of our complex society, would effectually obliterate the distinction between what is national and what is local and create a completely centralized government."[12] In sum, Congress may only regulate activities that have a substantial economic effect

on interstate commerce.[13] However, there is simply no evidence that activities involving certain intrastate waters, including roadside ditches, have a substantial economic effect on interstate commerce.

Proponents of the Restoration Act also argue that this legislation will provide greater clarity and certainty regarding the scope of the federal government's authority over water bodies. And while on one hand I would agree that expanding the government's authority to regulate *all* waters without limits certainly clarifies the intended scope of the government's authority, it is naïve to believe that such a legislative fix will bring about more certainty or lessen the confusion. Because the Restoration Act tests and likely exceeds the outer limits of the federal government's constitutional authority, it poses a substantial threat to long-established rights of property owners. Consequently, it will no doubt spawn significant litigation and uncertainty, and will keep many lawyers busy for years to come.

Mr. Murphy: Congress has ample authority to protect the waters the Restoration Act would protect. Primarily, Congress can protect such waters pursuant to its power to regulate interstate commerce. Congress also has ample authority under its power to implement international treaties and its power to manage all federal property.[23] In addition to these powers, Congress has power to "make all Laws which shall be necessary and proper for carrying into Execution" its enumerated powers.[24]

It is important to note that the Supreme Court's decisions in both *SWANCC* and *Rapanos* did not rule on constitutional grounds. Thus, neither ruling placed constraints on the type of waters Congress has constitutional authority to regulate under the Act. In fact, Justice Kennedy characterizes his own significant nexus test in *Rapanos*—which, while difficult to discern and apply, is believed by most commentators to be broad in scope and certainly extends well beyond traditionally navigable waters—as raising no federalism or constitutional concerns.[25]

The Commerce Clause[26] grants Congress broad power to regulate interstate commerce. This power gives Congress authority to regulate not only economic matters, but environmental, public health, social concerns, and other matters that affect interstate commerce. Indeed, virtually all of the major environmental statutes Congress has passed rely on the Commerce Clause for authority. In the face of frequent constitutional challenges to these laws, neither the Supreme Court nor any federal circuit court of appeals has struck down one of these laws as exceeding Congress's constitutional authority.[27]

The Commerce Clause provides three prongs of power under which Congress may regulate natural resources: (1) channels of interstate commerce; (2) instrumentalities, and persons or things in interstate commerce, and (3) activities substantially affecting interstate commerce.[28] While there are persuasive arguments for protecting water as an instrumentality of Commerce and the Supreme Court has found water to be an article of commerce,[29] this response will focus on the channels and substantially affects prongs. The Restoration Act would be upheld under both these prongs.

Navigable bodies of waters serve as "channels" of commerce and the law clearly recognizes that. But Congress's power under the channels prong does not stop with waters that are themselves navigable. Congress also has power to protect navigable waters from flooding, watershed development, and pollution, all of which can require the regulation of waters beyond the navigable waters.[30] This has been recognized for well over a century. The 1899 Refuse Act—a precursor to the CWA's Section 402 program— made illegal the discharge of materials into "any navigable water of the United States, or into any tributary of any navigable water."[31] Additionally, in 1941, the Supreme Court recognized that "the power of flood control extends to the tributaries of navigable streams."[32]

The channels prong therefore gives clear authority for Congress to regulate not only navigable waters themselves, but far upstream to waters that may impact navigable waters. The scope of such waters is, from an ecological standpoint, encompassing of virtually all surface waters within the watersheds of navigable waters.

In addition to the "channels" prong, Congress also has vast authority to protect waters under the "substantially affects" prong of the Commerce Clause. This prong allows Congress to regulate resources and activities that in the aggregate have a substantial affect on interstate commerce. This includes regulated activities or behavior that may individually have little effect on interstate commerce, so long as Congress has a rational basis to conclude such activities in the aggregate substantially affect interstate commerce.

Two cases in particular illustrate the sweeping scope of Congress's authority under the substantially affects prong. In *Wickard v. Filburn*, the Supreme Court found that federal quotas on wheat production applied to a grower who grew a small amount of wheat for personal consumption.[33] The Supreme Court reasoned that "even if [the] activity be local and though it may not be regarded as commerce, it may still, whatever its nature, be reached by Congress if it exerts a substantial economic effect on interstate commerce," and that, even though the wheat production at issue may be "trivial by itself," the grower's effect on interstate commerce, when "taken together with that of many others similarly situated, is far from trivial" as "[h]ome-grown wheat in this sense competes with wheat in commerce."[34]

This logic guided a more recent case, *Raich v. Gonzales*, where the Supreme Court upheld a federal ban on marijuana as it applied to intrastate use of medical marijuana that was neither bought nor sold. In *Raich*, the Court stated that "when a general regulatory statute bears a substantial relation to commerce, the *de minimis* character of individual instances arising under that statute is of no consequence."[35] Central to the Court's decision was that the statute at issue was "a lengthy and detailed statute creating a comprehensive [regulatory] framework."[36] Furthermore, there need only exist a "rational basis" for Congress to conclude that activities taken in the aggregate substantially affect interstate commerce for its exercise of power to be proper.[37]

The Supreme Court and federal appeals court rulings that have addressed comprehensive environmental regulatory schemes confirm that Congress's power to regulate natural resources under the Commerce Clause is similarly broad. Noted conservative Judge Richard Posner found, in discussing the Clean Water Act, that "navigability is a red herring from the standpoint of constitutionality. The power of Congress to regulate pollution is not limited to polluted navigable waters."[38] In *Hodel v. Virginia Surface Mining and Reclamation Association*, the Supreme Court looked in part to Congressional findings that surface-mining destroyed or diminished the utility of land for economic activity, contributed to floods, polluted waters, and had other deleterious effects that could impact commerce to uphold a comprehensive federal statute that regulates such activities, including intrastate sites.[39] Several circuit courts have also consistently upheld the constitutionality of the Endangered Species Act, which many consider to be among the most far-reaching of environmental laws.[40]

The aggregate commercial impacts of "isolated" waters and headwaters are indeed substantial. Drainage and destruction of these so-called "isolated" waters has been a factor in causing enormous flooding costing billions of dollars in damages. For instance, The Wetlands Initiative estimated that restoring lost wetlands in the upper Mississippi River basin, many of them "isolated," would have contained the flood waters of the enormously destructive 1993 floods in the Mississippi basin.[41] As Justice Kennedy noted in his *Rapanos* opinion, it is the degradation and destruction of small streams and wetlands in the far reaches of the Mississippi basin that have collectively caused an enormous annual dead zone in the Gulf of Mexico that has devastating consequences for industries dependent on sea life in the Gulf.[42] Moreover, "isolated" waters like Prairie Potholes comprise some of the most vital habitat for waterfowl production in the United States.[43] Bird-watching and hunting dependent upon such species is a multi-billion dollar interstate industry. Additionally, filling and destroying wetlands, streams, and other water resources is inherently economic activity. As such, there is plainly a rational basis for Congress to conclude the water resources that would be protected by the Restoration Act and the activities that impact them have an aggregate substantial affect on interstate commerce.

Outside of the Commerce Clause, the treaty power and Property Clause also provide separate constitutional bases for Congress to regulate waters that would be covered under the Restoration Act.

The scope of the treaty power[44] is set forth in *Missouri v. Holland*.[45] This case involved the validity of the federal government to enforce regulations that protected migratory birds pursuant to migratory bird treaties against the state of Missouri, which contended that it had ownership of wild birds in the state. Justice Holmes, writing for the Court, found protection of migratory birds to be "a national interest of very nearly the first magnitude" and concluded that "[i]f the treaty is valid there can be no dispute about the validity of the statute under Article 1, Section 8, as a necessary and proper means to execute the powers of the Government."[46]

The United States is under multiple treaties to protect migratory birds, some of which specifically mention the protection of migratory bird environments.[47] In order to carry these treaties out, Congress has power to protect resources used by migratory birds, including so-called isolated waters.

Additionally, the Property Clause[48] gives Congress power not only to protect resources on public land,[49] but also conduct on non-federal land that affects federal lands and resources.[50] This power would permit Congress to regulate all waters on public land in addition to waters on private land that might affect such public waters.

In sum, Congress has ample power to assert protection over the waters covered by the Restoration Act.

The Federalist Society: What effect would the CWRA have on the respective roles of the federal and state governments in managing water resources?

Mr. Fewell: When Congress established the Clean Water Act, it wisely created a framework of cooperative federalism, whereby the states and federal government are required by law to work together to protect the quality of the nation's waters. This framework is an important recognition that states have long had the primary responsibility to manage both land and water resources within their own jurisdictions. As Congress stated,

> It is the policy of the Congress to recognize, preserve, and protect the primary responsibilities and rights of States to prevent, reduce, and eliminate pollution, to plan the development and use (including restoration, preservation, and enhancement) of land and water resources...[14]

In carrying out the goals of the Act, Congress also directed the federal government to "co-operate with State and local agencies to develop comprehensive solutions to prevent, reduce and eliminate pollution in concert with programs for managing waters."[15]

By defining all waters, including intrastate waters, as waters of the United States, and regulating activities affecting such waters, the Restoration Act could not represent a clearer and more direct abrogation of the States' primary responsibility to manage land and water resources. No longer would there be a cooperative partnership between the states and the federal government. There would be no room or need for cooperation in the protection of water quality, as the federal government would then have complete and absolute control over the resources and dominate the regulatory space.

Currently, waters are classified as either waters of the United States or waters of the state. All waters of the United States are likewise waters of the state, but not all waters of the state are waters of the United States. A recent review of states' definitions of "waters of the state" reveal that states tend to define their waters more broadly than the Act defines federal waters, including natural and manmade water bodies.[16] For example, Arizona defines "waters of the state" as

> all waters within the jurisdiction of this state including all perennial or intermittent streams, lakes, ponds, impounding reservoirs, marshes, watercourses, waterways, wells, aquifers, springs, irrigation systems, drainage systems and other bodies or accumulations of surface, underground, natural, artificial, public or private water situated wholly or partly in or bordering on the state.[17]

By federalizing all waters, including waters that heretofore have only been subject to state law, states will lose their primary role to plan and develop their land and water resources as they see fit. And, in fact, the question then becomes, what becomes of the states' role in managing and regulating their own water and land resources? Invariably, the states would become a mere extension of the federal government to carry out the goals and requirements of federal law.

In addition to the obvious consequences of the Restoration Act, there are many unintended consequences of federalizing intrastate waters that would prove difficult for states and their respective citizens. This is particularly true because the amount of waters subject to federal jurisdiction and, thus, all the requirements under the CWA, would be substantially increased. As a result, water quality standards would automatically extend to all such waters, including roadside ditches, and the attendant obligations under the Act for the states to regulate and ensure that such waters achieve such standards. And where a ditch failed to meet such standards, the states would be required to develop a pollution budget and plan to ensure future compliance. Increasing the universe of federal waters would also require shifting already limited resources away from protecting higher quality waters to those, in some cases, with very little environmental or ecological value. In addition, because these waters would be federal, any activities affecting them would be required to obtain federal permits, whether pursuant to §402 (for wastewater discharges) or §404 (for fill and dredge materials). Requiring federal permits (whether individual or general permits) would substantially increase in the permitting workload for states as well as increase the requirements on individuals in need of permits for activities that otherwise do not require federal permits. Lastly, an individual's failure to obtain a permit if required could also result in serious civil and/or criminal penalties under the CWA.

Proponents of the Restoration Act argue that without new federal authority, 60% of the nation's important waters, 50% of the nation's streams, and 20 million acres of wetlands are unprotected and imperiled.[18] This is hyping a crisis that simply does not exist. And the argument wrongly suggests that there are no rules or regulations protecting the vast majority of our nation's water resources. The fact is that most states have the authority to protect such water bodies and, in fact, are doing so. This argument also ignores the importance of cooperative federalism and the proper role of States in regulating intrastate waters and local activities affecting such waters.

While environmental groups have long argued that states do not have sufficient resources or political will to protect valuable water resources, there is simply no compelling evidence to support this claim.[19] All states have wetlands regulations in place that protect various levels of protection.[20] And in fact there is strong evidence to the contrary. As of 2004, states such as Minnesota, Michigan, Massachusetts, Rhode Island, Maine, New Hampshire, New York, New Jersey, Connecticut, Maryland, Virginia, Florida, Vermont, Pennsylvania, and Oregon had all adopted comprehensive wetland legislation.[21] As well, when *SWANCC* was decided, numerous states, including Indiana, Ohio, South Carolina, and North Carolina, took immediate steps to fill the gap by extending state programs to protect those waters that were no longer subject to federal jurisdiction. Such a response by those states was appropriate and healthy and a signal that the CWA and its framework of cooperative federalism is working. This is not to suggest that states cannot do more nor that the federal government should not expect them to do more. However, this notion that all these wetlands and important waters are unregulated is simply not true.

It is also important to distinguish between the Restoration Act's goal of redefining and expanding the definition of "waters of the United States," as opposed to merely regulating activities that affect such waters. The fact that the Restoration Act aims to do both (i.e., expand geographic and activity-based authority), when only the latter approach is uniquely relevant to protecting water quality, raises the question of whether the unspoken purpose of the Restoration Act is more about regulating land use by redefining land subject to federal control as opposed to regulating activities that cause water pollution.

Much of the current national focus is on the need to better control and regulate nonpoint sources of pollutants—those characterized as diffuse, unconfined, and non-discrete conveyances—which currently are not regulated under the Act's Section 402 permitting program.[22] It is practicable and far preferable to regulate more broadly the various sources of pollution without expanding the definition of waters of the United States, as states are in a much better position to control such sources of water pollution. And, in fact, EPA and states are doing just that by expanding the universe of sources subject to federal regulation.[23] For example, EPA and some states are now resorting to using authorities under the Act which heretofore have not been widely used, such as the residual designation authority under Section 402(p), which allows the EPA or states to require a federal permit for a stormwater discharge that "contributes to a violation of a water quality standard or is a significant contributor of pollutants to waters of the United States." This represents but one of the many other tools and authorities under the Act to effectuate its goal of reducing pollution without the need to expand and redefine waters subject to federal regulation.

In sum, the CWA, although not perfect, is not broken and has worked fairly well in cleaning up and protecting the nation's waters. The solution to improving the nation's water quality is not through expanding the definition of waters of the United States, but encouraging greater cooperation and accountability between the states and the federal government. By federalizing all waters, the Restoration Act would, in the words of the Supreme Court, obliterate the distinction between what is national and what is local and create a completely centralized government. Such a result is unhealthy and destructive to our dual form of government.

Mr. Murphy: The Clean Water Act establishes a partnership between states and the federal government in administering and enforcing the Act. The Restoration Act will affirm the strong federal floor of protections that anchors this relationship. Without the certainty of a strong federal floor of protections, state programs, and protections are also at risk.

States play a strong role in administering and enforcing the CWA. Forty-six states administer a cornerstone program of the Act, the National Pollution Discharge Elimination System (NPDES) permitting system under Section 402 of the Act.[51] Two states, New Jersey and Michigan, administer the Section 404 dredge and fill program. Under Section 401 of the Act, all states have authority to certify that projects requiring federal licenses or permits and that discharge into jurisdictional waters meet water quality standards.[52] Additionally, pursuant to the Act, states receive various federal grants to help protect and clean-up waters.

Over the past thirty-six years, states have structured their water pollution regulatory laws and programs around the CWA, relying on the broad federal floor of protections to safeguard their waters. For instance, most states have no separate wetlands program, relying solely on the Section 404 program for protections. States have relied on their water quality certification authority under Section 401 of the Act to protect water quality from federally licensed projects—including those seeking Section 404 permits—that might pollute waters. Additionally, a handful of states have no more stringent than laws that prohibit them from regulating water more broadly than the federal government does. This list of states includes Arizona where water is precious, but approximately 96% of stream miles are intermittent or ephemeral and therefore at-risk of losing the Act's protections.[53]

As such, states have been fervent advocates of maintaining a strong federal floor of CWA protections. In 2003, over forty states objected to any administrative rollbacks of the Act's protections when the Bush Administration was considering re-writing the regulatory definition of "waters of the United States" in the wake of *SWANCC*. It was in part to these strong state objections that this potential regulatory rollback was derailed. Additionally, over thirty states urged the Supreme Court to uphold broad federal protections when it was considering *Rapanos*.

Other problems will fray the state-federal partnership if the current legal confusion is not speedily resolved. For instance, do Corps no-jurisdictional determinations under the Section 404 dredged and fill program mean that dischargers with state issued NPDES permits to those waters no longer need permits? Do water quality standards still apply to those waters? What about total maximum daily loads? In situations where EPA retains enforcement duties for NPDES violations, but where the state administers the program, can EPA enforce violations for waters protected under state law but no longer federally jurisdictional?

Furthermore, in states like Tennessee, where state protections are currently in place for waters now federally at-risk, intensive industry efforts are already underway to rollback these state laws.[54] It is only a matter of time before some of these efforts succeed and the "race to bottom" that prompted Congress to realize in 1972 that the states were not the proper guardians of trans-boundary resources like water begins anew.

The Restoration Act will resolve the current confusion and shore up the federal-state relationship that existed prior to 2001 and worked successfully for almost thirty years. Without passage of the Act, the complicated questions raised above will no doubt be worked out in a piecemeal fashion in the courts. The almost certain result of allowing that to occur will be conflicting decisions and continuing confusion, wasted time and money, and water protection programs that frustrate regulator and regulated alike without adequately protecting our waters.

Endnotes (Fewell)

1 33 U.S.C. § 1362(7).

2 *Id*. at § 1251(a).

3 Solid Waste Agency of Northern Cook County v. Army Corps of Engineers, 531 U.S. 159 (2001).

4 Rapanos v. United States, 547 U.S. 715 (2006).

5 H.R. 2421 (110th Congress, 1st Session), *available at* http://thomas.loc.gov/cgi-in/query/?c110:H.R.2421.

6 S. 787 (111th Congress, 1st Session), *available at* http://thomas.loc.gov/cgi-bin/query/z?c111:S.787.

7 33 U.S.C. § 1251(a)(1).

8 *Rapanos*, 126 S. Ct. at 2216 (plurality) and 2237 (concurrence). Both cite *Daniel Ball*, 77 U.S. 557 (1870).

9 U.S. Const., art. I, § 8.

10 The Federalist No. 45, 292-293 (1961).

11 514 U.S. 549 (1995).

12 JNLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 37 (1937).

13 Wickard v. Filburn, 317 U.S. 111, 125 (1942)

14 33 U.S.C. § 1251(b).

15 33 U.S.C. § 1251(g).

16 *See* Environmental Council of the States, *The States Definitions of "Waters of the State"*, February 2009.

17 Ariz. Rev. Stat. § 49-201.

18 *See* National Wildlife Federation, *How the Supreme Court Has Broken the Clean Water Act and Why Congress Must Fix It*, April 14, 2009.

19 *See, e.g.,* Eric Schaeffer, *Half of U.S. Wetlands Now Vulnerable Under Unwise Decision by U.S. Supreme Court*, June 22, 2006.

20 *See* Jonathan Adler, *Once More, With Feeling: Reaffirming the Limits of Clean Water Act Jurisdiction*, *available at* http://it.vermontlaw.edu/VJEL/Rapanos/9-Adler.pdf.

21 *See* Association of State Wetland Managers, "The SWANCC Decision, State Regulation of Wetlands to Fill The Gap," March 2004, *available at* http://www.aswm.org/fwp/swancc/aswm-int.pdf.

22 *See* PBS, "Poisoned Waters," *available at* http://www.pbs.org/wgbh/pages/frontline/poisonedwaters. Under the Clean Water Act, nonpoint sources are regulated through the § 319 nonpoint source management program, which requires among other things the States to "identif[y] those navigable waters within the State which, without additional action to control nonpoint sources of pollution, cannot reasonably be expected to attain or maintain applicable water quality standards or the goals and requirements of [the Clean Water Act]." 33 U.S.C. § 1329(a). Nonpoint sources are subject to federally mandated State programs that must employ best management practices to reduce water pollution. *Id.* Under § 319, the federal government is required to provide financial support and technical assistance to the states.

23 *See* http://www.epa.gov/NE/charles/pdfs/RODfinalNov12.pdf.

Endnotes (Murphy)

1 33 U.S.C. §1362(7).

2 *Id*. at §1251(a).

3 Solid Waste Agency of Northern Cook County v. Army Corps of Eng'rs, 531 U.S. 159 (2001).

4 Rapanos v. United States, 547 U.S. 715 (2006).

5 S. 787 (111th Congress, 1st Session).

6 118 Cong. Rec. 33,756-57 (Oct. 4, 1972).

7 *Id*.

8 123 Cong. Rec. 26,718 (Aug. 4, 1977).

9 United States v. Riverside Bayview Homes, 474 U.S. 121, 133 (1985) (citing S. Conf. Rep. No. 92-1236, p. 144 (1972); 118 Cong. Rec. 33756-33757 (1972) (statement of Rep. Dingell)).

10 International Paper v. Ouelette, 479 U.S. 481, 492 (1987).

11 Natural Resources Defense Council v. Callaway, 392 F. Supp. 685, 686 (D.D.C. 1975).

12 United States v. Ashland Oil and Transp. Co., 504 F.2d 1317, 1323 (6th Cir. 1974).

13 *Id*. at 1323-24 (quoting House Consideration of the Report of the Conference Committee, 118 Cong. Rec. 33756-57 (1972) (comments of Representative Dingell), reprinted in 1 Legislative History, at 250).

14 *Id*. at 1325 (quoting 118 Cong. Rec. 33756-57).

15 *SWANCC*, 531 U.S. at 172 (citing United States v. Appalachian Elec. Power Co., 311 U.S. 377, 407-08 (1940)).

16 *Rapanos*, 547 U.S. at 734 (emphasis in original).

17 *Id*. at 779 (Kennedy, J., concurring).

18 *Cf.* United States v. Johnson, 467 F.3d 56, 60 (1st Cir. 2006), *reh'g and reh'g en banc denied* (Feb. 21, 2007), *cert. denied* 128 S. Ct. 375 (2007) (either Rapanos plurality test or Justice Kennedy concurring opinion can establish jurisdiction) to United States v. Robison et al., 505 F.3d 1208, 1221 (11th Cir. 2007), *cert. denied,* 129 S. Ct. 627 (2008) (only Justice Kennedy test can establish jurisdiction).

19 Memorandum from Majority Staff Committee on Oversight and Government Reform, and Majority Staff, Committee on Transportation and Infrastructure to Rep. Henry A. Waxman Chairman, House Committee on Oversight and Government Reform James L. Oberstar Chairman, House Committee on Transportation and Infrastructure (Dec. 16, 2008); Memorandum from Granta Y. Nakayama, Ass't Administrator, EPA to Benjamin Grumbles, Ass't Administrator for Water, EPA (Mar. 4, 2008).

20 *Id*.

21 Petition for Writ of Certiorari of United States, Petitioner, United States v. McWane, Inc., et al. (Aug. 2008) at 30.

22 Letter from Benjamin H. Grumbles, Ass't Administrator, EPA to Jeanne Christie, Executive Director, Association of State Wetland Managers (Jan. 9, 2006) (mistakenly date-stamped Jan. 9, 2005).

23 The Spending Power, U.S. Const., art. 1, § 8, cl. 1, which allows Congress to condition receipt of federal funds, may also provide a basis for protecting certain waters, but this article will not discuss this potential basis.

24 U.S. Const., art. I, §8, cl. 18

25 *Rapanos*, 547 U.S. at 782 (Kennedy, J., concurring).

26 U.S. Const., art. I, §8, cl. 3.

27 See Environmental Law Institute (ELI), Anchoring the Clean Water Act: Congress's Constitutional Sources of Power to Protect the Nation's Waters (July 2007).

28 Gonzales v. Raich, 545 U.S. 1, 17 (2005) (citations omitted).

29 *See* Sporhas v. Nebraska, ex rel. Douglas, 458 U.S. 941, 954 (1982) (relating to ground water).

30 *See Daniel Ball*, 77 U.S. 557, 563 (1870) (setting forth the test for navigable in fact); United States v. Appalachian Power, 311 U.S. 377, 426 (1940) (the channels power is not limited to navigability but can encompass as commercial regulation such as flood protection and watershed development); United States v. Deaton, 332 F.3d 698, 706-07 (4th Cir. 2003 (channels prong includes keeping navigable waters free of injurious uses such as pollution) (citations omitted); *Ashland Oil*, 504 F.2d at 1325-26 ("water pollution is … a direct threat to navigation—the first interstate commerce system in this country's history and still a very important one").

31 Rivers and Harbors Act of 1899 (codified as amended at 33 U.S.C. § 407).

32 Oklahoma ex rel. Phillips. V. Guy F. Atkinson Co., 313 U.S. 508, 525 (1941).

33 Wickard v. Filburn, 317 U.S. 111 (1942).

34 *Id*. at 125-28 (citations omitted).

35 *Raich*, 545 U.S. at 17 (quotations and citations omitted).

36 *Id*. at 24.

37 *Id*. at 22.

38 United States v. Gerke, 412 F.3d 804, 807 (7th Cir. 2005), *cert. granted, judgment vacated by,* 548 U.S. 901, *on remand to,* 464 F.3d 723, (7th Cir 2006), *reh'g and reh'g en banc denied* (2006), *cert. denied* 128 S. Ct. 45 (2007) (citations omitted).

39 Hodel v. Virginia Surface Mining and Reclamation Association, Inc., 452 U.S. 264, 276-78 (1981).

40 E.g., Alabama-Tombigbee Rivers Coalition v. Kempthorne, 477 F.3d 1250 (11th Cir. 2007); GDF Reality Investments v. Norton, 326 F.3d 622 (5th Cir. 2003); Rancho Viejo, LLC v. Norton, 323 F.3d 1062 (D.C. Cir. 2003); Gibbs v. Babbitt, 214 F.3d 483 (4th Cir. 2000).

41 Donald L. Hey, Ph.D. et al, Flood Damage in the Upper Mississippi River Basin: An Ecological Alternative (Aug. 6, 2004) at 2.

42 *See Rapanos*, 547 U.S. at 777 (Kennedy, J., concurring).

43 U.S. Geological Survey, Northern Prairie Wildlife Research Center, Prairie Basin Wetlands in the Dakotas: A Community Profile, at Preface, *available at* http://www.npwrc.usgs.gov/resource/wetlands/basinwet/preface.htm.

44 The treaty power is derived from art. 2, §2, cl. 2 of the Constitution which gives the President the power to make treaties with the advice and consent of the Senate, the Necessary and Proper Clause, and the Supremacy Clause of art. VI, §1, cl. 2.

45 Missouri v. Holland, 252 U.S. 416 (1920)

46 *Id*. at 432, 435.

47 *See* ELI, Anchoring the Clean Water Act, at 12 (detailing treaties protection migratory birds to which the United States is a party).

48 U.S. Const., art. IV, §3, cl. 2.

49 E.g., United States v. Cotton, 52 U.S. 229, 231-32 (1851).

50 E.g. Camfield v. United States, 167 U.S. 518, 525-26 (1897); United States v. Alford, 274 U.S. 264, 267 (1927) ("Congress may prohibit the doing of acts upon privately owned lands that imperil publicly owned forests") (citation omitted).

51 *See* http://cfpub.epa.gov/npdes/stateinfo.cfm (providing information regarding administration of NPDES program in all fifty states); 33 U.S.C. § 1342 (b).

52 33 U.S.C. §1341.

53 Letter from Stephen A. Owens, Director, AZ Dep't of Environmental Quality to Benjamin H. Grumbles, Ass't Administrator, Office of Water, U.S. Environmental Protection Agency (Dec. 5, 2007) at 2 (stating that 96 percent of AZ stream miles are non-perennial).

54 *See* TN House Bill HB1617 (2009 session) and Senate Bill SB633 (2009 session) (both seeking to remove state level protections for ephemeral streams or "wet weather conveyances").

This Much is Clear: The Failure to Recognize Statutory Ambiguity in *National Cotton Council v. EPA*

*By Ellen Steen & Jessica A. Hall**

The Sixth Circuit recently struck down an EPA Clean Water Act (CWA) regulation that sought to define reasonable boundaries of the National Pollutant Discharge Elimination System (NPDES) permitting program in the context of pesticide use.[1] For CWA practitioners, the decision is significant for its sweeping expansion of the definition of regulated "point source" discharges and the resulting implications for a wide range of activities now subject to the threat of CWA enforcement. But it is also noteworthy for followers of administrative law generally, because of the court's invalidation of an EPA regulation and 35 years of consistent agency practice based on what may reasonably be characterized as conclusory assertions of the statute's "plain" meaning, rather than faithful adherence to the traditional *Chevron* analysis.

The *NCC* decision, in a single blow, negates more than three decades of agency practice and dramatically expands the NPDES permitting program to cover at least an estimated 5.6 million pesticide applications annually.[2] This article describes the decision and its implications for pesticide application and a wide range of other activities now potentially subject to CWA permitting requirements and liability under the panel's reasoning.[3] But our primary focus is how the decision offends fundamental principles of administrative law by improperly imposing the panel's own interpretation over the agency's patently reasonable construction of the statutory text through formal rulemaking.

Chevron Then and Now

The modern standard for judicial review of agency interpretations of statutes traces to the Supreme Court's decision in *Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc.*[4] Although most administrative law practitioners can readily recite the *Chevron* rule of deference to reasonable agency interpretations, it is useful occasionally to be reminded of the statutory provisions and agency policies at issue in that case.

In 1977, Congress amended the Clean Air Act to deal with states that had failed to attain EPA's national air quality standards. The amendments required these "non-attainment" states to establish a strict permitting program to regulate "new or modified major stationary sources" of air pollution.[5] In August 1980, under the Carter Administration, EPA issued regulations defining the term "stationary source" in the statute to mean any individual piece of equipment in a plant that produced pollution.[6] Under the Reagan Administration, however, EPA began to reconsider its approach.[7] One reason for the reconsideration was EPA's belief that the 1980 definition could "act as a disincentive to new investment and modernization by discouraging modifications to existing facilities" and might "actually retard progress in air pollution control by discouraging replacement of older, dirtier processes or pieces of equipment with new, cleaner ones."[8] In October 1981, EPA therefore adopted a new definition of "stationary source" that allowed for a plant-wide definition.[9] This new definition made it possible for an existing plant to install new equipment without meeting stringent new source performance standards, as long as the total emissions from the plant (as if it were encased in a "bubble") did not increase. Some environmental groups, which viewed EPA's change in policy as an improper relaxation of environmental requirements, successfully challenged EPA's plant-wide definition in the D.C. Circuit.

The Supreme Court reversed. In an opinion by Justice John Paul Stevens, the Court upheld EPA's new interpretation of "stationary source" to mean an entire facility, not just a specific pollution-emitting device. In doing so, the Court articulated the now-familiar two-step standard for judicial review of an agency's construction of a statute that it administers:

> First [Step One], always, is the question whether Congress has *directly spoken to the precise question* at issue. If the intent of Congress is clear, that is the end of the matter; for the court as well as the agency, must give effect to the unambiguously expressed intent of Congress. If, however, the court determines Congress has not directly addressed the precise question at issue, [in Step Two] the court does not simply impose its own construction on the statute, as would be necessary in the absence of an administrative interpretation. Rather, *if the statute is silent or ambiguous with respect to the specific issue*, the question for the court is whether the specific agency's answer is based on a *permissible construction* of the statute.[10]

The *Chevron* Court explained that judges should defer to reasonable agency interpretations both when Congress has explicitly created a gap for the agency to fill and when it has done so implicitly—such as through statutory ambiguity or silence.[11] This applies equally to statutory gaps left intentionally and inadvertently—such as when Congress simply did not consider the precise question at issue.[12] In finding that it was appropriate to defer to EPA's interpretation of "source" in the Clean Air Act, the *Chevron* Court was influenced by the fact that the regulatory scheme at issue was "technical and complex," and that the agency had "considered the matter in a detailed and reasoned fashion."[13] The Court observed, moreover, that judges do not share the same level of expertise or political accountability that executive agencies experience.[14] For this reason:

> When a challenge to an agency construction of a statutory provision, fairly conceptualized, really centers on the wisdom of the agency's policy, rather than whether it is a reasonable choice within a gap left open by Congress, the challenge must fail."[15]

Twenty-five years later, *Chevron* still provides the framework for judicial review of agency interpretations of the statutes they administer, particularly when those interpretations are embodied in regulations promulgated using notice and comment procedures.[16] Indeed, the Supreme Court has twice

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this year (both since the *NCC* ruling was issued) invoked *Chevron* in reversing appellate courts' erroneous "plain language" decisions in the CWA context and affirming EPA's contrary interpretations.[17] The analysis of the Court in *Entergy* (as well as the dissenting opinion in that case) in particular, presents an illuminating contrast to the Sixth Circuit panel's cursory treatment of the statutory text. Later in this article, we discuss *Entergy*, as well as a recent case in which the Eleventh Circuit swallowed hard and properly applied *Chevron* to uphold a CWA rule that deviated from the court's preferred interpretation of the statute. But first, we describe the background and fate of EPA's CWA pesticide rule.

EPA's CWA Pesticide Rulemaking

Statutory Background

The CWA prohibits the "discharge of any pollutant" to waters of the United States, except in compliance with certain statutory provisions.[18] One of those provisions, Section 402, establishes the NPDES permitting program and authorizes EPA or an approved state agency to issue NPDES permits for the discharge of pollutants under specified terms and conditions.[19] NPDES permits must contain technology-based limits on the pollutant discharge, in addition to more stringent limits as necessary to meet applicable "water quality standards" for the receiving waters.[20]

A few key terms define the scope of the NPDES regulatory program. "Discharge of a pollutant" means the "addition of any *pollutant* to navigable waters *from any point source*."[21] "Pollutant" means "dredged spoil, solid waste, incinerator, residue, sewage, garbage, sewage sludge, munitions, chemical wastes, biological materials, radioactive materials, heat, wrecked or discarded equipment, rock, sand, cellar dirt and industrial, municipal, and agricultural waste discharged into water."[22] "Point source" means a "discernible, confined and discrete conveyance."[23] "Navigable waters" means "waters of the United States," which has been interpreted to include both navigable-in-fact waters and other waters with a substantial nexus to such waters.[24] Any pollution-generating source that falls outside the scope of the regulated universe as defined by these terms is categorized as a "nonpoint source" and is not subject to federal regulation under the CWA.

In addition to the regulatory program for point source discharges, the CWA establishes a variety of non-regulatory programs in furtherance of the statutory goal of protecting and maintaining the quality of the nation's waters. For example, states (with EPA oversight and approval) must establish "water quality standards" for all navigable waters, review and adjust those standards periodically, and establish plans for the achievement of those standards.[25] States must identify specific waters not attaining water quality standards and establish "total maximum daily loads" (TMDL) sufficient to achieve standards.[26] TMDLs are incorporated into NPDES permits for permitted discharges and are implemented through regulatory or non-regulatory state programs for nonpoint sources.[27]

For context on the CWA pesticide rule, background on one additional statute is needed. The Federal Insecticide, Fungicide, and Rodenticide Act (FIFRA) authorizes EPA to regulate the sale, distribution, and use of pesticides through a registration program. EPA may not issue a registration for a pesticide that causes "unreasonable adverse effects on the environment."[28] The statute defines "unreasonably adverse effects on the environment" to include "any unreasonable risk to man or the environment."[29] In approving any pesticide registration, EPA must approve label requirements that prescribe the purposes for which and the manner in which the pesticide may be applied.[30]

CWA Pesticide Rulemaking

In August 2003, EPA issued an interim interpretive statement and requested public comment as the initial step in what would become a three-year process of developing a regulation to address the applicability of the NPDES permitting program to pesticide application.[31] Although EPA had never—in three decades administering the CWA—required an NPDES permit for pesticide application, clarification was necessitated by several court rulings, including a Second Circuit decision observing that there was ambiguity under current law regarding whether "properly used pesticides can become pollutants that violate the Clean Water Act."[32]

EPA's interpretive statement declined to address pesticide application generally, but identified two discrete circumstances in which pesticides applied from a point source to waters of the United States, consistent with all relevant requirements of FIFRA, are not "pollutants" under the CWA and, therefore, do not require an NPDES permit.[33] The first scenario involved the application of pesticides directly to waters of the U.S. to control pests, such as mosquito larvae or aquatic weeds.[34] The second scenario involved the application of pesticides to control pests that are present over waters of the U.S., such as adult mosquitoes, where the application results in a portion of the pesticide being deposited to waters of the U.S.[35] After considering public comment, EPA finalized its interpretive statement and proposed formal rulemaking to codify that interpretation in 2005.[36]

EPA published its final rule in November 2006.[37] Consistent with the agency's prior interpretive statement, the final rule codified two specific instances in which the application of pesticides in accordance with all relevant FIFRA requirements (i.e., those related to water quality) would not trigger NPDES permitting requirements because the pesticide being applied is not a "pollutant." The two circumstances were:

1. The application of pesticides *directly to waters* of the U.S. in order to control pests. Examples of such applications include applications to control mosquito larvae, aquatic weeds, or other pests that are present in waters of the U.S.

2. The application of pesticides to control pests that are present *over waters* of the U.S., *including near such waters*, where a portion of the pesticides will unavoidably be deposited to waters of the U.S. in order to target the pests effectively; for example, when insecticides are aerially applied to a forest canopy where waters of the U.S. may be present below the canopy or when pesticides are applied over or near water for control of adult mosquitoes or other pests.[38]

EPA's rule expressly left unaddressed the question of pesticide applications to "terrestrial agricultural crops,"[39]

which might involve "drift over and into waters of the United States."[40] Such terrestrial applications, for which EPA also has never required or issued an NPDES permit, are the subject of the Pesticide Program Dialogue Committee, a Federal Advisory Committee Act committee formed to advise EPA on issues related to pesticide "spray drift" from agricultural and other pesticide applications.

EPA's interpretation was based on its determination that pesticides in use in the specified circumstances are not "pollutants." Of the 16 items listed in the statutory "pollutant" definition, pesticides could potentially be classified as either "chemical wastes" or "biological materials." EPA reasoned that chemical pesticides being applied for their intended purpose of controlling pests and in accordance with all relevant FIFRA labeling requirements are not "eliminated or discarded" products, and thus are not "chemical wastes." Rather, they are products that EPA has evaluated and registered for the purpose of controlling target organisms, including controlling pests through application of the pesticide to water. EPA further reasoned that the term "biological material" is ambiguous as to whether it includes biological pesticides being applied in accordance with FIFRA requirements. EPA interpreted the term to exclude such pesticides, largely because the contrary conclusion would lead to the anomalous result that biological pesticides would be regulated as "pollutants" under the same circumstances in which chemical pesticides would not. Based on the predominance of chemical pesticides when the relevant statutory provisions were enacted, and the generally more environmentally benign nature of biological pesticides, EPA reasoned that Congress probably did not intend to regulate biological pesticides under the circumstances addressed in the rule.

EPA acknowledged throughout the rulemaking process that pesticides remaining in the environment *after* their intended purpose had been served—so-called "residual materials"—are waste and therefore properly viewed as "pollutants." Yet even if such materials will be generated as a result of pesticide application, EPA concluded that the application itself is not properly regulated under the CWA, because the pesticide is not a "pollutant" *at the time of its discharge* from a point source (the application equipment). In other words, the application of pesticides under the circumstances identified in the rule is not an "addition of any *pollutant*… *from* any point source" because the pesticide is not a "pollutant" when it comes "from" the application equipment.[41] In EPA's view, therefore, pesticide residual that may remain in the environment following application is appropriately viewed as "nonpoint" source pollution and addressed through other CWA and state programs.

Judicial Review of the CWA Pesticide Rule

Challenges to the Rule

Environmental and industry groups[42] filed petitions for review of EPA's CWA pesticide rule. Petitions filed in eleven circuits were ultimately consolidated in the Sixth Circuit. Farming and forestry groups intervened in defense of the rule.

The environmental groups argued that EPA exceeded its authority under the CWA by excluding *any* pesticide application—even under the carefully cabined circumstances spelled out in the rule—from the NPDES permitting requirement. The industry groups, on the other hand, argued that EPA's exemption was too narrow: even pesticide application *not* in compliance with FIFRA should be excluded from regulation as a CWA "pollutant" discharge.

The Panel's Decision

On January 7, 2009, the Sixth Circuit panel vacated the rule. The court first addressed EPA's interpretations of the term "pollutant." With regard to chemical pesticides, the panel agreed that only "waste" pesticide—i.e., excess or residual—is a "chemical waste" and therefore a CWA "pollutant."[43] On this basis, the panel identified "at least two" circumstances in which chemical pesticides are "pollutants."[44] The first is when pesticide is initially applied to land or dispersed into the air (including applications within the scope of the rule that target pests "over… including near" waters) and "[a]t some point following application, excess or residual pesticide finds its way into the navigable waters."[45] The second circumstance is when a chemical pesticide is applied "directly and purposefully to navigable waters to serve a beneficial purpose" and "residual aquatic pesticide 'remain[s] in the water after the application and [the pesticide's] intended purpose has been completed.'" In both scenarios, consistent with EPA's interpretation, any excess or residual pesticide in the waters as a result of the application is a "pollutant."[46]

With regard to biological pesticides, however, the panel found that the CWA phrase "biological materials" (included in the "pollutant" definition) unambiguously encompasses "matter of a biological nature, such as biological pesticides."[47] According to the panel, all biological pesticides under all circumstances are "pollutants," regardless of whether they result in any excess or residual material after their purpose has been served.[48] Therefore, any application of biological pesticide to navigable waters would be a discharge of a pollutant to those waters.

Although EPA's interpretation had sought to avoid inconsistent regulatory treatment of chemical and biological pesticides, that concern proved to be academic in light of the next stage of the panel's analysis. Turning to whether chemical pesticide residues are discharged "from a point source" or, as EPA determined, are nonpoint source pollution, the panel rejected EPA's determination.[49] Although EPA concluded there is no point source pollutant discharge where the pesticide is not a "pollutant" *at the time of the discharge* from the application equipment, the panel found that "EPA's attempt at temporally tying the 'addition' (or 'discharge') of the pollutant to the 'point source' does not follow the plain language of the [CWA]."[50]

To flesh out its own interpretation of the circumstances in which excess or residual pesticide is discharged "from a point source," the panel turned to a separate EPA rulemaking and an Eleventh Circuit decision (which had been vacated on other grounds), both of which concerned whether the transfer of polluted waters from one waterbody to another is an "addition of any pollutant to navigable waters from any point source."[51] In the context of discussing such water

transfers, EPA had noted its "longstanding position… that an NPDES pollutant is 'added' when it is introduced into a water from the 'outside world' by a point source."[52] EPA made the statement in discussing its conclusion that "outside world" does not include a different navigable waterbody, so that transfers between navigable waterbodies are not an "addition… to navigable waters."[53] Also, in the context of water transfers, the Eleventh Circuit had rejected an argument that such transfers do not discharge pollutants "from" pumping stations because the pumping stations are not the "original source" of the pollutants.[54] According to the Eleventh Circuit, the "relevant inquiry is whether—but for the point source—the pollutants would have been added to the receiving body of water."[55] Thus, in the Eleventh Circuit's view (prior to EPA's promulgation of a regulation to the contrary), the pumping of polluted waters from one navigable waterbody into a receiving water where they would not naturally flow is a regulated discharge of pollutants "from" the pumping station because the pollutants would not be present in the receiving water "but for" the pumping station.

Finding the reasoning of these extraneous sources both relevant and persuasive, the *NCC* panel found it "clear" that "pesticide residue or excess pesticide… is a pollutant discharged from a point source because the pollutant is 'introduced into a water from the 'outside world' by' the pesticide applicator from a point source.'"[56] Formulated in terms of the Eleventh Circuit's "but for" test, the panel found that pollutants are deemed to be "from" a point source if the pollutants would not be present in the waters "but for" the point source.[57] According to the panel: "It is clear that *but for* the application of the pesticide, the pesticide residue and excess pesticide would not be added to the water; therefore, the pesticide residue and excess pesticide are from a 'point source.'"[58]

Petition for Rehearing

Respondent-intervenors (but not EPA)[59] petitioned for rehearing or rehearing en banc. The petition contends that the CWA is at least ambiguous as to whether a substance must be a "pollutant" at the time it is emitted from a point source for there to be a discharge of a pollutant "from a point source." Focusing on the ordinary meaning of statutory terms, the petition argues:

> The panel's construction is contrary to the common understanding of the word "from." One cannot spray ice "from" a hose, or squeeze butter "from" a cow. Likewise, pesticide *waste* is not discharged "from" application equipment during pest control activities merely because some portion of the pesticide product may *in the future* become excess or residue. At the very least, there is sufficient ambiguity in the statute to require deference to EPA's reasonable interpretation.

The petition also highlights the dramatic—presumably unintended—change in the scope of CWA regulatory jurisdiction that would be wrought by the panel's "but for" test to identify regulated "point source" discharges. NPDES permitting historically has been limited to circumstances in which (1) a "pollutant" is emitted from a conveyance (e.g. pipe, ditch, or vessel) and (2) the conveyance has some proximate relationship to navigable waters, such that it conveys pollutants to those waters. Yet the panel's "but for" test would reach across time and space, imposing NPDES permitting requirements on virtually any activity that can be identified as a "but for" cause of future pollution to waters. Potentially regulated pollutant "discharges" include: applying lawn fertilizer; salting a road, parking lot, or sidewalk; washing a car; even applying sunscreen or mosquito repellant—all "but for" causes of pollutants that find their way to waters. The point, of course, is not that the Sixth Circuit or other courts will ultimately require NPDES permitting for the application of sunscreen—but that the panel's "plain language" interpretation is at odds with the traditional scope of the NPDES permitting program and embodies no limiting principle to define *which* pollution-causing activities are subject to those requirements. This alone casts serious doubt on the panel's conclusion that its interpretation is a reasonable—let alone the *only* reasonable—construction of the statute.

Critique of the Sixth Circuit's "Plain Language" Analysis

For many CWA practitioners, the *NCC* ruling illustrates the wrong turns law can take when judges apply their own construction of a statute in the face of contrary agency rulemaking—particularly in the context of a complex regulatory scheme. Judges and CWA practitioners distinguishing or disagreeing with the ruling in the CWA enforcement context will likely see the decision as a poster child for judicial deference to administrative interpretation—a perfect example of why judges should resist the urge to impose their independent assessment of the "best" interpretation of statutory text, even in furtherance of laudable goals such as protecting water quality.

The fundamental error in the decision is the panel's refusal to recognize ambiguity in the statutory phrase "discharge of any pollutant"—defined as "addition of any *pollutant* to navigable waters *from a point source*." EPA—reasonably, we contend—interpreted the phrase to mean that a pollutant must be a pollutant *at the time* it is emitted "from" a point source. Thus, the discharge of a pesticide *product* under the circumstances described in the EPA rule is not a regulated "discharge of a pollutant" even if the product becomes a "pollutant" (excess or residual material) some time, perhaps a short time, *after* its release from a point source. EPA explained its interpretation this way:

> [P]esticide applications [within the scope of the rule] do not require NPDES permits, even if the application leaves residual materials which are "pollutants" under the Act in waters of the United States.… The [CWA] defines "discharge of a pollutant" to mean "any *addition* of any pollutant to navigable waters from *any point source.*" … In this case, while the discharge of the pesticide is from a point source (generally a hose or an airplane), it is not a pollutant at the time of the discharge.… Even though the pesticide may become a "pollutant" at a later time (*e.g.*, after the pesticide product has served its intended purpose), a permit is not required for its application because it did not meet both the statutory prerequisites (pollutant and point source) at the time of its discharge into the water. Instead, the residual should be treated as a nonpoint source pollutant, potentially subject to CWA programs other than the NPDES permit program.[60]

Although EPA's interpretation would appear to have firm grounding in the words of the statute, the panel vacated

the rule with only conclusory assertions that it contradicts the statute's "plain language"—mocking EPA for the purported lack of judicial precedent on the issue.[61] The entirety of panel's analysis of the provisions at issue follows:

> … according to the EPA, pesticides at the time of discharge do not require permits because they are not yet excess pesticides or residue pesticides. But there is no requirement that the discharged chemical, or other substance, immediately cause harm to be considered as coming from a "point source." Rather, the requirement is that the discharge come from a "discernible, confined, and discrete conveyance," 33 U.S.C. § 1362(14), which is the case for pesticide applications.
>
> The EPA offers no direct support for its assertion…. This omission of authority is understandable, as none exists. The [CWA] does not create such a requirement. Instead, it defines "discharge of a pollutant" as "any addition of any pollutant to navigable waters from any point source." … EPA's attempt at temporally tying the "addition" (or "discharge") of the pollutant to the "point source" does not follow the plain language of the Clean Water Act.[62]

Immediately following this eisegesis is a discussion of the broader statutory goals that purportedly illuminate the statute's plain meaning. According to the panel:

> [EPA's interpretation]… is also contrary to the purpose of the permitting program, which is "to prevent harmful discharges into the Nation's waters." *Defenders of Wildlife*, 127 S.Ct. at 2525. If the EPA's interpretation were allowed to stand, discharges that are innocuous at the time they are made but extremely harmful at a later point would not be subject to the permitting program. Further, the EPA's interpretation ignores the directive given to it by Congress in the [CWA], which is to protect water quality. As the EPA itself recognizes [in the water transfers rulemaking discussed above], "Congress generally intended that pollutants be controlled at the source whenever possible." 73 Fed. Reg. at 33,702 (citing S.Rep. No. 92–414, p. 77 (1972)).[63]

Finally, venturing entirely beyond the statute, the panel drew its own interpretation of "pollutant… from a point source" from prior EPA statements and an Eleventh Circuit opinion applying the phrase in the distinct context of water transfers.[64] Based on those sources, and in presumed furtherance of the broader goals of the statute, the panel reasoned that the statute can *only* be construed to regulate any point source emission of a substance that is a *but for* cause of pollutants that ultimately enter waters.[65]

We submit that a proper *Chevron* analysis gives more serious consideration to the potential for alternative reasonable interpretations of the text. In *Entergy*, for example, the Court upheld EPA's reasonable interpretation of the phrase "best technology available for minimizing adverse environmental impact" to allow consideration of cost-benefit analysis in determining which technology was "best."[66] Various environmental groups and states argued (and the Second Circuit agreed) that the phrase must be read to mean the economically feasible technology that achieves the *greatest possible reduction* in environmental harm.[67] While acknowledging that this was a plausible interpretation of the statute, the Court explained that it was not necessarily the *only* interpretation: "Best technology may also describe technology that *most efficiently* produces some good. In common parlance one could certainly use the phrase 'best technology' to refer to that which produces a good at the lowest per-unit cost."[68] Because the statutory text allowed room for EPA's construction, the Court found that the agency's view must be upheld.

Perhaps the *NCC* panel so easily settled on the wrong conclusions in part because it failed to ask the difficult questions posed in *Chevron*, *Entergy*, and countless decisions in between. In particular, the panel's opinion never poses the fundamental questions:

- Has Congress *directly spoken* to the *precise question* whether the application of a pesticide to or over waters constitutes a "discharge of a pollutant"?[69]
- Is EPA's interpretation a *reasonable* construction of the statute—even if not the only possible interpretation or the interpretation deemed *most* reasonable by the court?[70]

Because the text of the relevant provisions reveals no clear direction on the precise question and (at the very least) *allows for* the agency's construction, we further submit that the general CWA goals to "prevent harmful discharges" or "protect water quality" cannot justify invalidation of the rule.[71] The Eleventh Circuit's recent analysis in *Friends of the Everglades v. South Florida Water Management Dist.*[72] is instructive. Finding that the regulation at issue (EPA's water transfer regulation discussed above) embodied a permissible construction of the statutory provisions at issue, the court upheld the rule notwithstanding the court's acknowledged preference for a different interpretation and, indeed, despite the court's recognition that the rule arguably would *not* further the CWA's broad goal of protecting water quality.

Friends of the Everglades argued that EPA's water transfer rule would lead to absurd results, in that it would exclude from NPDES permitting requirements even the pumping of "the most loathsome navigable water in the country into the most pristine one," contrary to the CWA's water protection goals.[73] In the court's view, however, inconsistency with the CWA's "broad and ambitious" goals cannot resolve the ambiguity of the text itself to preclude EPA's otherwise reasonable construction of an ambiguous provision.[74] The court observed that "there are other provisions of the [CWA] that do not comport with its broad purpose… ," chief among them the limitation of the permitting program to "point source" discharges notwithstanding the recognized water quality effects of nonpoint source pollution.[75] Since not *every* provision of the CWA can be said to further its broad purposes, those purposes cannot resolve ambiguity in favor of an interpretation that would further those goals and against another interpretation that arguably would not. As the court explained:

> … even when the preamble to legislation speaks single-mindedly and espouses lofty goals, the legislative process serves as a melting pot of competing interests and a face-off of battling factions. What emerges from the conflict to become the enactment is often less pure than the preamble promises. The provisions of legislation reflect compromises cobbled together by competing political forces and compromise is the enemy of single-mindedness. *It is not difficult to believe that the legislative process resulted in a*

Clean Water Act that leaves more than one gap in the permitting requirements it enacts.[76]

The Eleventh Circuit's treatment of the CWA's water quality protection goals contrasts sharply with the Sixth Circuit panel's decision to vacate the CWA pesticide rule as "contrary to the purpose of the permitting program, which is 'to prevent harmful discharges into the Nation's waters.'"[77] We contend that the Eleventh Circuit's approach is more true to *Chevron*'s goal of ensuring that authorized agencies, not judges, "make such policy choices—resolving the competing interests which Congress itself either inadvertently did not resolve, or intentionally left to be resolved by the agency charged with the administration of the statute in light of everyday realities."[78] Indeed, if the CWA's ambitious water protection goals (including the elimination of *all* pollutant discharges by 1985) provide the clarity requisite to end a *Chevron* analysis at Step One, then Congress must be presumed to have left few gaps in the CWA for the agency to fill—whenever one interpretation is more protective of water quality, that interpretation must govern.[79]

CONCLUSION

The subjectivity inherent in the search for "clear" congressional intent weakens *Chevron*'s utility as a guide to judicial decision-making.[80] Under the *NCC* panel's ruling, EPA's CWA pesticide regulation is an unfortunate casualty of that subjectivity. Perhaps such casualties would be minimized, and judicial decision-making improved, by strict adherence to the Step One analysis as framed by the *Chevron* Court: "First, always, is the question whether Congress has *directly spoken* to the *precise question* at issue."[81]

Posing and answering this question logically requires that judges both: (1) articulate the *precise* question at issue,[82] and (2) identify evidence of specific congressional intent on that question.[83] The rigor of this analysis alone—in black and white, for all to see—may sharpen judicial thinking and bring into better focus Congress's actual intent (if any).[84] Undoubtedly, the failure to undertake this level of inquiry and to present the Step One analysis in roughly these terms leaves more room within which judges may comfortably impose their own statutory interpretation without due regard for the reasonable alternative interpretation of the agency charged to administer the statute.

Endnotes

1 Nat'l Cotton Council of Am. v. Envt'l Prot. Agency, 553 F.3d 927 (6th Cir. 2009) ("*NCC*").

2 EPA's motion to stay the *NCC* mandate estimated that the ruling would require NPDES permitting for *at least* the following categories of application "to, over, or near waters of the United States," which the agency estimated would amount to 5.6 million applications annually: mosquito larvicides; mosquito adulticides; herbicides used to control weeds in lakes and ponds, irrigation systems, and other waterways; herbicides used to control weeds along ditch banks; insecticides used in wide-area insect suppression programs; herbicides used in wide-area control programs directed at aquatic invasive plan species; and pesticides used in forestry programs when applied over waters of the United States.

3 We refer to the decision as the "panel's" ruling because, at the date of this writing, respondent-intervenors' petition for rehearing *en banc* remains pending.

4 467 U.S. 837 (1984).

5 *Chevron*, 467 U.S. at 840.

6 *Id*. at 857.

7 *Id*. at 857-58.

8 *Id*. at 858.

9 *Id*.

10 *Chevron*, 467 U.S. at 842-43 (emphasis added).

11 *Id*. at 843.

12 *Id*. at 865-66.

13 *Id*. at 865.

14 *Id*. at 865.

15 *Id*. at 866.

16 U.S. v. Mead Corp., 533 U.S. 218, 234-38 (2001) ("administrative implementation of a particular statutory provision qualifies for *Chevron* deference when it appears that Congress delegated authority to the agency generally to make rules carrying the force of law, and that the agency interpretation claiming deference was promulgated in the exercise of that authority.).

17 *See* Entergy Corp. v. Riverkeeper, 129 S.Ct. 1498 (2009), and Coeur Alaska, Inc. v. Southeast Alaska Conservation Council, No. 07-984 (June 22, 2009).

18 33 U.S.C. § 1311(a).

19 *See id.* § 1342. EPA may administer the NPDES program and issue discharge permits directly, or it may authorize states to administer the program and to issue NPDES discharge permits within their jurisdictions. *Id.* § 1342(b). EPA has approved 45 states and the Virgin Islands to administer NPDES programs under state or territorial law. A separate permitting program under CWA § 404 regulates the discharge of pollutants that constitute "dredged or fill material." *See id.* § 1344.

20 *Id.* § 1311(b)(1)(C).

21 *Id*. § 1362(12) (emphasis added).

22 *Id*. § 1362(6).

23 *Id.* § 1362(14).

24 *See* Rapanos v. U.S., 547 U.S. 715, 778-83 (2006).

25 *Id.* § 1313(c) and (e).

26 *Id.* § 1313(d).

27 *See id*. § 1329 (nonpoint source management program); 40 C.F.R. Part 130 (EPA regulations concerning water quality planning and management).

28 *See* 7 U.S.C. §§ 136a(c)(5) & (7).

29 *Id.* § 136(bb).

30 7 U.S.C. § 136a(c)(1)(C), (c)(5)(B), (c)(6).

31 *See* 68 Fed. Reg. 48,385 (Aug. 13, 2003).

32 Altman v. Town of Amherst, 46 Fed. App'x 62, 67 (2d Cir. 2002). *See also* Headwaters, Inc. v. Talent Irrigation Dist., 243 F.3d 526 (9th Cir. 2001); League of Wilderness Defenders/Blue Mountain Biodiversity Project v. Forsgren, 309 F.3d 1181 (9th Cir. 2002).

33 68 Fed. Reg. at 48,387.

34 *Id.*

35 *Id.*

36 *See* 70 Fed. Reg. 5093 (Feb. 1, 2005).

37 71 Fed. Reg. 68,483 (Nov. 27, 2006).

38 *Id*. at 68,492 (codified at 40 C.F.R. § 122.3(h) (2007)) (emphasis added).

39 *Id.* at 68,486.

40 *Id.* at 68,487.

41 In contrast, the discharge of pesticide *residues* from a point source – such as industrial or municipal discharges, or certain regulated stormwater discharges – would involve a "pollutant" discharge "from a point source." *See* 71 Fed. Reg. at 68,487.

42 "Industry" petitioners included several pesticide manufacturers and their trade association CropLife America, as well as several agricultural groups, including the National Cotton Council.

43 *NCC*, 553 F.3d at 936-37.

44 *Id.* at 936.

45 *Id.*

46 The court decided each issue presented – the meaning of "pollutant" as applied to both chemical and biological pesticides, and whether pollutant residues resulting from application are discharged "from a point source" – based on the plain language of the CWA and without deference to EPA. With respect to whether and under what circumstances chemical pesticides are "pollutants," the court agreed with EPA. With regard to the remaining two issues, the court arrived at a different interpretation.

47 *Id.* at 937.

48 *Id.* at 938.

49 *Id.* at 938-40.

50 *Id.* at 939.

51 *Id.* at 940.

52 *Id.* (quoting 73 Fed. Reg. 33,697, 33,701 (June 13, 2008)).

53 *See* 73 Fed. Reg. at 33,701.

54 South Fla. Water Management District v. Miccosukee Tribe of Indians, 280 F.3d 1364, 1368, n.6 (11th Cir. 2002).

55 *Id.* at 1368.

56 553 F.3d at 940.

57 *Id.*

58 *Id.* (emphasis added).

59 Under new political leadership since the case was briefed, EPA did not petition for rehearing. EPA instead moved to stay the court's mandate for two years, to allow EPA and the States time to develop and issue NPDES permits to authorize at least some of the pesticide applications affected by the ruling. In response to that motion, issuance of the mandate has been stayed until April 9, 2011.

60 71 Fed. Reg. at 68,487 (emphasis in original).

61 As argued in the Petition for Rehearing En Banc, the lack of judicial precedent *explicitly* addressing the issue (*i.e.*, substances that become pollutants *after* being emitted from a point source) simply shows that this is a novel question, not that EPA's interpretation is far-fetched. Indeed, examination of numerous CWA decisions finding a "discharge" has revealed *none* where the substance involved was not a "pollutant" at the time it was emitted from the "point source."

62 553 F.3d at 939.

63 *Id.*

64 *See infra,* text accompanying notes 51-58.

65 *Id.* at 939-40.

66 129 S.Ct. at 1508, 1510.

67 *Id.* at 1506.

68 *Id.*

69 *See Chevron*, 467 U.S. at 842.

70 *See Entergy*, 129 S.Ct. at 1505. While the second question is the second step of the *Chevron* analysis as originally formulated, the majority in *Entergy* observed that it can just as properly be posed at the outset, because its answer will necessarily resolve Step One as well. *Id.* n.4 ("But surely if Congress has directly spoken to an issue then any agency interpretation contradicting what Congress has said would be unreasonable.") One advantage of proceeding in this fashion (which essentially collapses the two-step inquiry into a single question) is that it would tend to minimize the bias that may naturally result when judges first independently arrive at their own interpretation of a statute before confronting whether the agency's contrary interpretation is also permissible. *See* Matthew C. Stephenson & Adrian Vermeule, Chevron *Has Only One Step,* 95 Va. L. Rev. 597, 605 (2009).

71 *See* 553 F.3d at 939.

72 2009 WL 1545551 (11th Cir. June 4, 2009).

73 *Everglades*, 2009 WL 1545551 *14.

74 *Id.* at *14-15. Thus, the "broader context of the statute as a whole" did not resolve the ambiguity. *Id.* (citing Robinson v. Shell Oil Co., 519 U.S. 337, 341 (1997), and Koons Buick Pontiac GMC, Inc. v. Nigh, 543 U.S. 50, 60 (2004)).

75 *Id.* at *15.

76 *Id.* (emphasis added).

77 553 F.3d at 939.

78 *Chevron*, 467 U.S. at 865-66.

79 The recent *Entergy* and *Coeur Alaska* decisions both establish that the CWA's general water quality goals do not make otherwise ambiguous provisions "clear" for purposes of *Chevron* Step One. Both decisions involved a finding of ambiguity and deference to EPA's interpretation despite the fact that an alternative reasonable interpretation would be more protective of water quality. *See* Entergy, 129 S.Ct. at 1504; Coeur Alaska, Slip Op., dissenting opinion by J. Ginsburg, at 1 (EPA's interpretation, which would exclude discharges of fill material from CWA § 402 permit requirements and stringent new source performance standards, would allow a discharge that would "kill all of the lake's fish and nearly all of its other aquatic life.")

80 *See* Antonin Scalia, *Judicial Deference to Administrative Interpretations of Law*, 1989 Duke L. J. 511, 520 ("How clear is clear?").

81 467 U.S. at 842 (emphasis added).

82 In *Chevron*, for example, the question was whether Congress had any "specific intention on the applicability of the bubble concept in these cases." 467 U.S. at 845.

83 Of course, where there is evidence of specific congressional intent favoring one interpretation, but there is *also* evidence that Congress intended an alternative interpretation, the result is that the statute is ambiguous as to the question presented. *See Coeur Alaska*, slip op. at 17-18. Moreover, the lack of evidence of specific intent on the question at issue should not be overcome by general expressions of statutory goals, for the reasons discussed in connection with *Everglades, supra* note 73, and at note 78.

84 Just as important, the search for evidence of *specific* congressional intent aids in identifying situations in which Congress simply did not consider the matter and thereby left a "gap" for the agency to fill. *See Chevron*, 467 U.S. at 865. In those situations, one may proceed to consideration of what Congress *would have intended*, had it considered the matter, but only in the context of the Step Two inquiry into whether the agency's interpretation is reasonable.

Federalism and Separation of Powers

The Founders' Intent, Constitutional Provisions, and Limits on Spending Power and Delegation

National Press Club, Washington, D.C., March 19, 2009

Wayne Abernathy: Good morning. Welcome to this symposium, co-sponsored by the Federalist Society and the Chapman University School of Law ["The Financial Services Bailout: Cause, Effect, and the Limits of Government Action." See Multimedia Archive for audio/video; www.fed-soc.org].

I recall not very long ago, Secretary Paulsen rolled out one of the many different programs he put forward last fall to deal with the financial crisis, explaining how this particular program would really turn things around. Well, as we know, that didn't happen, but what has happened since reminds me of a passage in *Don Quixote*. I'm sure Cervantes didn't make it up, but it goes like this: If you turn into honey, you will be eaten by flies. Considering all the bailouts for this and that industry and the long queue that now forms each morning outside of the Treasury Department, we might consider the wisdom of the old Spaniards.

A couple weeks ago, we had an interesting discussion in my office on the question of who owns the Federal Reserve. For an agency that has such an important role in our society, the answer, surprisingly, disturbingly, is not entirely clear. But it is an important question because today the Federal Reserve, in addition to its normal monetary policy role, has taken on some very significant responsibilities. Just one example, a news article much like any that you could find on just about any day of the week, a wire story by *Reuters*: "Fed to Buy Long-Term U.S. Government Debt." Just a couple of brief highlights:

The Federal Reserve on Wednesday said it would pump an additional $1 trillion into the U.S. economy to try to pull out of a deep recession, partly by buying longer-term government debt for the first time in more than 40 years. The decision caught many off guard. U.S. stocks shot higher and yields on U.S. government bonds took their biggest one-day tumble since 1987, while the dollar plunged to a two-month low against the Euro. In addition to purchasing treasury debt, the Fed said it would expand by $850 billion to $1.45 trillion, an existing program to buy debt and securities issued by mortgage finance agencies.

This, in any normal time, would be breathtaking. But it comes after a series of events beginning last fall when, as I mentioned, Secretary Paulsen put forward a number of proposals to deal with the financial situation—and after Congress appropriated a breathtaking $700 billion to buy up the troubled assets of various financial institutions. It may be valuable, by the way, to keep in mind that Congress first voted against that proposition before they voted for it; they have been on both sides of this issue.

Of course, no sooner was the program enacted than Secretary Paulsen announced that he was going to spend the first $250 billion, not on buying troubled assets, but actually making investments in healthy banks to $250 billion of worth at capital purchase program, the other $100 billion spent on a variety of other projects. Now, so far as I can tell, little of the money in the first tranche Secretary Paulsen had control over went to buying troubled assets, and, in one of the most astonishing revelations by any sitting Treasury Secretary, he later owned up to the fact that by the time the President was signing that bill into law, he already knew it would not work and was working on the next project. He recognized buying troubled assets is pretty tough to figure out how to do.

One of my first responsibilities as Assistant Secretary of Treasury from December 2002 through January 2003 was to put into place the Terrorism Risk Insurance Program (TRIP). That program had a very interesting feature to it very few people recognized, a provision I think that is totally unprecedented. It said that TRIP was authorized to appropriate without fiscal year limitation such sums as are necessary to run the program. In other words, there was no limit to how much we could spend on the program. No limit at all. We could have spent trillions. Of course, we didn't; we were very frugal in how we put that system together. But we didn't have to be. There was no limit on the appropriation, either an amount or time, and I have to say today, it frightens me to think what Secretary Paulsen might have done with that authority if he had it to rely upon.

What are we think in the land of "We the People" about such broad grants of financial authority, particularly when we're taught in our civics classes that the power of the purse strings is the way in which Congress maintains its balance in this checks and balances system of government that we have. Here it seems the purse is open and given with very little instruction to the Executive branch; it is run as they see fit.

The questions we will look at today is, is that appropriate? Is that constitutional? Does the need justify the law? And is the need so great that those kinds of actions are necessary? In each case they were enacted, that was the argument: the need was so great that flexibility has to govern the allocation and use of those funds. But are there constitutional lines that we should not cross?

We are very privileged to have two distinguished scholars of the Constitution with us here today. Let us begin with Dean Eastman.

John C. Eastman: Thank you very much, Mr. Abernathy. Chapman University School of Law is delighted to be participating as a co-sponsor of this important program. I flew in from California, 3,000 miles away, last night, and so I am going to give you a bit of a bird's-eye view of some of these

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constitutional issues, not a line-by-line or section-by-section analysis of TARP or TARP II or the spending bill or the stimulus bill or those things. There are hundreds and hundreds of pages in all these bills, as you know, and, if anybody can get standing, the cases are going to work their way through the courts for many years to come. Nor am I going to give you an analysis of what the current precedent supports, because the current precedent supports just about anything. If it is spending, everything qualifies as in the general welfare. All delegations are in the public interest. We don't have to have any more of an intelligible principle than "go forth and do good". Rather, I am going to give you a plea to use this current crisis to reconsider some of those precedents and to ask whether they should not be revisited in light of the catastrophic damage they have caused to the constitutional design bequeathed to us by our nation's founders.

Let me tell you a story from the last election. In our town of Long Beach, California, where my wife and I live, there was a little internal improvements ballot initiative. They wanted to raise money via bonds to expand a couple of roads and fill some potholes and take down some damaged trees. The bond measure failed. The voters who were going to benefit from this spending didn't think it was worth the cost.

Instead of acknowledging the voters' decision, the city leaders immediately said, well, since it failed here, let's get in that line at the Treasury Department and ask for some of the stimulus spending or TARP funds. Now, the question that the City's response brought to my mind was this: If the people who were going to benefit directly, the ones whose houses were along side of the streets that were going to be repaired, didn't think it was worth the money, why in Heaven's name would we think that the people in Rhode Island or Georgia or Arkansas would think it was worth the money? But that is essentially what all these claims to federal largess amount to.

At the time of our founding, there was a Scottish history professor named Alexander Tyler completing a lengthy study of democracies who had a particular book about the fall of the Athenian republic. He wrote a very interesting thing. He said that democracies are always temporary in nature; they simply can't exist as a permanent form of government. The democracy will continue to exist up until the time that voters discover that they can vote themselves generous gifts from the public treasury. From that moment on, the majority always votes for the candidates who promise the most benefits from the public treasury, with the result that every democracy will finally collapse over loose fiscal policy, which is always followed by a dictatorship. The average age of the world's greatest civilizations from the beginning of history, he reported, had been about 200 years. During those 200 years, nations always progressed through the following sequence: from bondage to spiritual faith, from spiritual faith to great courage, from courage to liberty, from liberty to abundance, from abundance to complacency, from complacency to apathy, from apathy to dependence, and from dependence back into bondage. I leave it all for you to figure out where on that continuum we are. I think it's unfortunately too close to the end.

I want to talk about a couple of major challenges or constitutional problems I see with the whole range of federal government efforts lately. The first is the Spending Clause, and the second I will group together under non-delegation of legislative powers problems. Again, on both of these I think the precedent is clearly against me. My question is: Ought it to be?

The Spending Clause in Article I, Section 8 of the Constitution gives Congress the power to tax for the common defense and general welfare. And today we think "general welfare" means anything the Congress decides is going to be good. The fight at the Founding, however, was rather different. James Madison thought this was the trigger clause, that we could raise and spend money to give effect to any of the subsequent enumerated powers in Article I, Section 8. Alexander Hamilton thought otherwise, but even Hamilton, who was among the broadest of federal power interpreters of the time, thought the General Welfare Clause had its own limits in the general or national welfare, not for the local or regional welfare.

I want to give you a couple of examples from the early days of Congress as it confronted just what authority this clause conferred. The first Congress refused to make a loan to a glass manufacturer that needed funding to get up and running—you might call it a stimulus loan—after several members in the House expressed a view that such an appropriation would be unconstitutional. During the second Congress there was a protracted debate that occurred over a bill to pay a bounty to the New England cod fishermen. The purpose of this was to try and bail out a struggling cod fishery industry in New England. The fourth Congress didn't even believe it had the power to provide relief to the citizens of Savannah, Georgia after a devastating fire destroyed the entire city; think Katrina. The requested support was in the local welfare, but it was not in the general welfare, in Congress's view, and the relief effort was therefore thought to be unconstitutional.

I think this debate demonstrates just how solicitous of the general welfare limitation Congress was. Many of these early members of Congress had actually participated in the Constitutional Convention. Representative Gillis contended that paying a bounty on certain occupations was of doubtful constitutionality, and argued that the general welfare limitation was parallel to the requirement of Article 1, Section 9 that direct taxes be levied only in proportion of state population. The Spending Clause afforded no power to gratify one part of the union, he said, by oppressing another, and any other reading of it would render the restriction on direct taxes meaningless.

In remarks that are an uncanny description of contemporary politics, he continued, "Establish the doctrine of bounties. Set aside that part of the Constitution which requires equal taxes and demands similar distributions. Destroy this barrier, and it is not a few fishermen that will enter claiming $10,000 or $12,000, but all manners of people, people of every trade and occupation may enter in at the breach until they have eaten up the bread of our children." That line outside Treasury is longer and longer every day, and we're no longer talking about eating up the bread of our children or even our grandchildren but of our great-great grandchildren.

Now this view of Congress was accepted. It became a contested matter over the election of 1800, with the Jeffersonian "limits on spending" position prevailing. And from 1800 to

1860 almost every president adhered to the same view. As President, Madison vetoed an internal improvements bill that was to build roads and canals in a number of local areas. Such a view of the Constitution would have the effect of giving to Congress a general power of legislation instead of a defined in limited one hereto understood to belong to them. The terms "common defense" and "general welfare" would, if we expand it, include every object and act within the purview of legislative trust. And so he recommended we continue to read a more narrowly.

Andrew Jackson was elected President in part to put to rest the dangerous doctrine that we can spend for any local matter we want. He vetoed as unconstitutional bills that would have appropriated $200 million to purchase stock in the Maysville and Lexington Turnpike Company, again to provide a stimulus that company to help get it up and running. And this was just going to be the direct construction of ordinary roads and canals. So strong was his veto message that Congress didn't even try another bill for another four years, and when they finally did, he responded forcefully with this:

We are in no danger from violations of the Constitution by which encroachments are made upon the personal rights of the citizen. A sentence of condemnation long since pronounced by the American people upon acts of that character will no doubt continue. But against dangers of unconstitutional acts, which instead of menacing the vengeance of offended authority, proffer local advantages and bring in their train the patronage of government, we are, I fear, not so safe.

To suppose that because our government has been instituted for the benefit of the people it must therefore have the power to do whatever may seem to conduce to the public good is an error into which even honest minds are apt to fall. In yielding to this fallacy, they overlook the great considerations in which the federal Constitution was founded.

In consequence of the diversity of interests and conditions in the different states, it was foreseen that although a particular government measure might be beneficial and proper in one state, it could well be the reverse in another. It was for this reason that the states would not consent to make such a broad grant of federal power to the government.

President Polk found before him a bill to provide funding to the territory of Wisconsin. This was appropriate funding under the federal government's plenary powers over the territories, but like many of our bills today, Congress started with a small nugget of constitutional funding and then piled on millions and millions of additional funding that had nothing to do with the constitutional authority. It was $6,000 for Wisconsin, and then another half-million, which was serious money in those days, in the appropriation bill for the improvement of harbors and rivers in other parts of the country.

Polk's veto message is really important. He said, "The Constitution is a wise one that provides important safeguards. Both the state legislatures and Congress have to concur in the act of raising funds. They are in every instance to be levied upon the commerce of those ports which are to be profited by the proposed improvement." In other words, under the Constitution, the one kind of local funding that was authorized was to impose tonnage duties to pay for port improvements, "the expenditure being made in the hands of those who are to pay the money and are going to be immediately benefitted". So there was this tie between money and benefit, unlike the Long Beach example I began with. And as a result of that tie, "the spending will be more carefully managed and more productive of good than if the funds were drawn from the national treasury and disbursed by the officers of the general government, that such a system will carry with it no enlargement of federal power and patronage and leave the states to be the sole judges of their own wants and interests, which only a conservative negative in Congress, upon any abuse of the powers of the states, may attempt." I think, again, what we've lost in this whole discussion in recent decades is this tie between those benefited and those who have to pay for the benefit, and you get the amount of spending in line when you keep that tie.

President Polk then went on to suggest with uncanny prescience what would happen if we adopted the opposite interpretation the Constitution. He said, "When the system of federal funding for internal improvements prevailed in the general government and was checked by President Jackson, it had begun to be considered the highest merit in a member of Congress to be able to procure appropriations of public money to be expended within his district or state, whatever might be the object. We should be blind to the experience of the past if we did not see abundant evidences that if this system of expenditure is to be indulged in, combinations of individual and local interest will be found strong enough to control legislation, absorb the revenues the country and plunge the government into a hopeless indebtedness." This morning's additional 1.2 trillion in spending demonstrates, I think, that we are well past the "hopeless indebtedness" point.

"But a greater practical evil," Polk continued, "would be found in the art and industry by which appropriations would be sought and obtained. The most artful and industrious would be the most successful. The true interests of the country would be lost sight of in the annual scramble for the contents of the Treasury, and the member of Congress who could procure the largest appropriations to be expended in his district would claim the reward of victory from his enriched constituents. The necessary consequence would be sectional discontents and heart burnings, increased taxation and the national debt never to be extinguished."

I won't go into it, but President Buchanan said the same thing, and this view of the limits on the spending power was affirmed by the Supreme Court in *Butler*, not rejected, despite how many people now, in hindsight, view that case.

The point here is that we've completely lost any sense of limits on federal spending and the damages that will flow from that spening. It is true in TARP, or at least the portions dealing with what we might call earmark-type funding. It's certainly true in the stimulus package. It's true in the second half of the current fiscal year's budget bill. It's already starting to be true in the budget for the next fiscal year. And I think it was almost uniformly agreed that the federal Constitution didn't confer this sort of power. And there has been no amendment that would confer it since then.

Let me now switch to a different set of problems with the TARP bill in particular. The standard view of the non-delegation

doctrine is that because the Vesting Clause in Article I of the Constitution says that all legislative powers herein granted are vested in a Congress, Congress can't delegate its lawmaking powers to agencies and certainly not to private actors unless they do so with a sufficiently intelligible principle to constrain or guide the conduct of the agency. Now that limit on the delegation of lawmaking power has long since been ignored. We have allowed for delegations that do everything as broad as the Federal Communications Commission regulating in the public interest. There is no intelligible principle there in theory. So what that means is there's nothing left of the non-delegation doctrine.

But if there's ever a set of circumstances that should force us to reconsider whether we want to impose or reinject some teeth into a non-delegation doctrine, it would seem to me the current mess should be it. Back on September 4, in a letter that was ultimately endorsed by more than 231 economists at American universities around the country, it was noted that one of the major pitfalls in the various bills proposed at the time, which ultimately became TARP, was their ambiguity. Neither the mission nor the oversight were clear. If taxpayers were to buy illiquid and opaque assets from troubled sellers, the terms, the conditions, the methods should have been made crystal clear in order to comply with this intelligible principle. None of that was done.

In fact, just the opposite. We radically changed the understanding of what was going to be accomplished shortly after the bill was passed. Section 101 of the TARP bill talks about purchases of troubled assets; the Secretary was authorized to establish TARP to purchase and make and fund commitments to purchase troubled assets from any financial institution. Part of the initial efforts last fall actually do fit within some of that language, even though if you looked at just that authority, you would think, well, "troubled assets" is pretty clear.

But "troubled assets" is defined more broadly: We're going to pick up the residential or commercial mortgages or any securities or obligations that are based on them. But then there's this second half of the definition—"any other financial instrument that the Secretary determines is necessary to promote financial market stability." That is so open-ended as to not amount to any intelligible principle confining the scope of authority of the Secretary.

You see this immediately play out. The original bill was $250 billion, as Mister Abernathy said in his opening remarks, but the President was allowed to move that up to $350 billion on his own if he just certified that more was necessary. Again, "necessary" based on what?—in his own decision. Under a true non-delegation doctrine principle, that was probably too broad. President Bush immediately did that. Then the additional $350 billion could be released. There was a written report from Congress describing its plan for the money. That was done back in January, again, without much greater definition on what was to be accomplished.

The best example of why I think this violates the non-delegation doctrine is the auto bailout. As Mr. Abernathy said, the first allocation of TARP money was not used to buy up troubled assets but rather was used to buy preferred stock in thriving concerns. It did not seem to meet the purpose of the statute at all. It was outside the intelligible principle, to the extent there was one, of what was authorized. But even if that was a close call because of the broad definition of "troubled assets", the auto bailout was not a close call at all; nobody thought it was. If you remember the early days when the auto bailout effort was run through Congress. Only after Congress refused to adopt the bill did President Bush decide to use, unilaterally, his executive authority to say, well, we'll now treat this as a troubled asset so that we can use TARP funds. Where in the definition could that be done? And if the definition was so flexible as to allow that which one day was impermissible under TARP to suddenly by Executive Order alone become permissible, then TARP has to be in conflict with the non-delegation doctrine. It's something that Congress itself considered and rejected. So how this doesn't violate the non-delegation doctrine is beyond me, if there's anything left of a non-delegation doctrine whatsoever. And again, there's not.

So our question ought to be why not, and can we get back some notion of a non-delegation doctrine? Congress faced this as a legislative policy matter. They rejected it. We ought not let the Executive unilaterally do something that everybody understood at the time was unauthorized.

Let me look at a couple more problems with TARP that I see. Again, precedent supports this, but the question is, should it? Article I, Section 7 of the Constitution requires that all bills for raising revenue shall originate in the House of Representatives, but the Senate may propose or concur with amendments as on other bills. Now we have for a long time completely ignored this, or gone through the motions without meeting the substance of this constitutional requirement. What happened here is a good example of going through the motions.

The bill started off as a three-page proposal to the House of Representatives by Secretary Paulsen. The House expanded it 110 pages, and that was offered as an amendment to House Bill 3997. This so far comports with Article I, Section 7's Origination Clause. But that bill failed in the House of Representatives on September 29. The Senate then took a completely unrelated bill, gutted it, and amended it to put it in their version. So HR 1424 becomes the bill, even though the financial revenue enhancing aspects did not in any sense of the discussion originate in the House of Representatives. The Senate approved it, sent it back to the House, they approved it a day later, and the President signed it.

Now this may just be formalistic, but these provisions are in the Constitution for a reason, and our ability to ignore them or find a way around them through this sleight of hand ought to give us all cause for concern.

Another example of constitutional provisions ignored is the Appropriations Clauses (Article 1, Section 9), which provides: "No money shall be drawn from the Treasury,, but in consequence of appropriations made by law." Now it cannot be the case that the appropriation Mr. Abernathy talked about—where you have no limit--that cannot be what the Constitution's limit on appropriations means. And yet the Fed has been operating as if it had such authority—I mean where did they get the $1.2 trillion to buy up all these bonds? They just make it up. Because the federal government is on

the hook, this is an appropriation not made by law, not even by regulation; we're just doing this stuff. These basic decisions about how much debt to take on, spending decisions that are supposed to be made by Congress, are not even going through the constitutional structure here. Let me leave it at that, because I want to get Professor Seidman up here, and he can counter this and then we can open up for questions.

My point, again, is not to say that Supreme Court precedent doesn't authorize these actions. The question is, is what's going on here so severe, with consequences so potentially catastrophic, that it's time to revisit the founders' wisdom that the limits on federal government are there for a reason? And the reason comes home to roost in a big way with these various bills—can we get ourselves out of it by looking back to the original wisdom of the founders?

Thank you.

Abernathy: Thank you, Dean Eastman. The stage is all set. It's now yours, Professor Seidman.

Louis Michael Seidman*: Thank you, Mr. Abernathy, and I want to thank Dean Reuter for inviting me to this event. I just love coming to these Federalist Society events. As I have remarked before, for reasons I'm not sure I want to think about too carefully, I am the Federalist Society's favorite leftist. I get invited here much more often than I get invited to the American Constitution Society. I was telling Dean Eastman this right before the session, and he suggested it was maybe because I was a cheap date—which may be the case.

Eastman: His phrase, not mine.

Seidman: But in all seriousness, there is one thing I really appreciate about doing this. I know there are very few, if any, people in this audience who agree with my perspective. But without fail people are polite, open-minded, and engaged, and I'm really are grateful for that.

One disadvantage of appearing before this organization, however, is that I don't get to frame the topic. If I had, I probably would have framed it a little differently. The topic assumes that we are interested in the intent of the Framers. To put no fine point on it, I would not want to live in a country governed by the intent of the Framers. It would be unrecognizable as the country we live in now. I can give you many examples, but I will confine myself to two.

If we followed the intent of the Framers, racial segregation would be legal in the District of Columbia and probably in the rest of the counrty as well.When Chief Justice Roberts testified at his confirmation hearings he was asked to name his favorite justice, and answered Robert Jackson, at which point I really scratched my head—because Jackson is also my favorite justiceand I thought that one or the other of us has to have this wrong. One of the things I like about Jackson—and this was not known at the time, but it's known now because the Court's conference notes are available—is that, when *Brown* was being considered, Jackson wrote both a draft opinion and a memo to his colleagues, arguing that there was no basis whatsoever for the decision in the Constitution; (Justice Frankfurter said the same thing). It violates the Framers' intent, it violates the text, it violates past precedent. Nonetheless, he wrote, I am for *Brown* on political and moral grounds. It is a good thing.—even though Jackson

Here's another much more trivial example, but one I really like. If one were to follow the text of the Constitution and the intent of the Framers, the Senate as presently constituted would be plainly unconstitutional. Why do I say that? Well, Article I, Section 3 is very precise about the term of office senators are to serve. All serve a six-year term except the first 26 senators, who drew lots and served two-, four- or six-year terms, so that their terms would be staggered. From the time the first new state (Vermont) entered the union to the present we have just flatly, blatantly ignored that provision so that when each new state has entered one of the senators has served less than six years in order to stagger the election.

Last time I noticed, the country hasn't fallen apart. Perhaps our failure to follow this constitutional provision caused the financial collapse, but somehow I don't think so. We've managed quite nicely. God hasn't come down upon us with his wrath because we disobeyed that section of the Constitution. We've just done it.

So I would not frame this debate in terms of the Framers' intent, but I'm stuck with the topic you have chosen, so I will talk about the original intent and the text. Most sophisticated conservatives today think we ought to follow the public meaning of the text, rather than the Framers' intent. But let's talk about them both, and in conjunction with the two topics Dean Eastman mentioned: the spending power and the delegation doctrine.

First, with regard to the spending power, let's start with the basics. Article 1 Section 1 gives Congress the authority to spend in the general welfare. It doesn't say one word about whether the spending has to be local or national. It doesn't say anything about spending being confined by the other powers of Congress. It just says it has to be in the general welfare. That's it. So far as I know, there's nothing in the constitutional debates that suggests anything other than what the language suggests, that it be simply in the general welfare.

It is true that Madison held a non-textual position that spending had to be limited by the other clauses of the Constitution, like the commerce power. And as Dean Eastman indicated, one of the great debates in the 19th century was about internal improvements. The dean cited a number of Democratic presidents who were against internal improvements, but, had he been on the other side of the debate, he could have cited a number of Whigs who were *for* internal improvements. That was a big political debate. But it's also a fact that Madison's view has been rejected for almost a century, that it's now virtually uniformly agreed that Hamilton was right. Indeed, the Roosevelt-era Court that struck down big chunks of the New Deal agreed with Hamilton in the *Butler* case, and that is really unambiguous. The Court says Hamilton was right, Madison was wrong, the Spending Clause means what it says, you can spend money simply in the general welfare.

But let's forget all that. Suppose Dean Eastman is right and

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the Constitution means local spending is unconstitutional, and that spending has to, in some sense, be national. Now the first thing I want to say is I'm not at all clear what the distinction is between local and national. We have some history of dealing with this problem.When the Supreme Court has concerned itself with this, it has repeatedly been unable to define these firms. And I notice that Dean Eastman didn't define them either. But whatever they mean, surely the spending on the stimulus is national.

We are now in the greatest recession or depression since the 1930s. The gross national product went down by six percent last quarter. That is a national problem. This is not something going on in Long Beach. It's something going on in the United States. The gross national product measures the interstate commerce; even in the Madisonian view, Congress has the power to deal with this crisis under the Spending Clause. Maybe the stimulus package is misguided. Maybe it's just a big mistake. Maybe we should do nothing. But, so far as the Constitution is concerned, it seems to me beyond question that the spending addresses a national problem not confined to individual states and not solvable by them. It is a problem about the sharp and radical decline of interstate commerce.

What about delegation? Dean Eastman is a smart man, and very articulate, but I think even he might concede that his position is truly radical. There are many government agencies operating today where the delegated power is much looser than in TARP, where they're told simply to operate in the public interest. The Supreme Court has again and again upheld those delegations.

Why is that? Well, first of all one ought to be careful what one wishes for. Although the Court has not enforced the non-delegation doctrine, Congress has shown increasing interest in and is enforcing it. When it does, what is that called? I'll tell you what it's called: it's called earmarks. That is what enforcement of the Non-Delegation Clause means. Congress says, no, no, we're not going to delegate to some faceless bureaucrat whether to build a bridge to nowhere; damn it, you build it. That's non-delegation. I didn't think the Federalist Society was in favor of that practice, but I guess Dean Eastman is in favor of it.

Now what about the legal basis for this argument? Once again, there's absolutely no basis in the text of the Constitution for this, nor, I think, any basis in the legislative history of the adoption of the Constitution. Very conservative scholars like Adrian Vermeule and Eric Posner have made this point recently. What the text of the Constitution requires is that Congress pass statutes; that's all it says. And Congress passed the statute creating TARP. Ironically, in the name of protecting the right of Congress to pass statutes, what Dean Eastland would do is strike down the statute that Congress passed because he doesn't like it. Well, the Constitution doesn't have any Eastman provision in it that says if you don't like it, you get to strike it down. It's for the Congress to decide what statutes to pass and how much power to delegate.

This gets me to my last point, which I don't think this audience is going to accept, but one I can't resist making. I think this whole debate reflects a misunderstanding about what American constitutional law is all about. It's a very widespread misunderstanding, but a misunderstanding nonetheless. The view here is that constitutional law is some sort of disinterested, political, antiseptic effort to discover the truth about some foundational document or the truth about what some long dead people thought 200 years ago. That's not what it's about. Maybe it should be; I don't happen to think so. But the fact of the matter is that's not how anybody, right, left or center, plays the game.

Let me make two points about this. First, and I'm just guessing here—Dean Eastman is a good sport, taking all this; he can tell me if I'm wrong—but my guess is Dean Eastman did not vote for Barack Obama for president. My guess is that on the merits, on political and economic grounds, he is opposed to TARP. He thinks it's a really bad idea. He thinks the auto bailout is a bad idea. He thinks most of what President Obama has done is a bad idea. And maybe he's right about that. We'll see. But are we really supposed to believe that those views have nothing to do with the constitutional argument he's making today, that it's just a happy coincidence that these political positions are the same as the views that you get from an apolitical, disinterested reading of the constitutional text? Maybe it is, but I have to say I doubt it, and what I doubt even more is this really strange coincidence that Justice Thomas's totally apolitical reading of the text leads him to think that it basically incorporates the platform of the Republican Party, and Justice Ginsburg's totally apolitical reading of exactly the same text leads her to think that it incorporates the platform of the Democratic Party.

This leads me to my second and last point. Whatever the merits of Dean Eastman's argument, it isn't going to happen; and the reason is constitutional law doesn't work never work the way he thinks it works. We've been down this road before. In that other Great Depression, the Supreme Court said the government efforts to stop it violated the Spending Clause (*Butler*) and the non-delegation doctrine (*Schechter*), and you know what happened? It almost destroyed the Supreme Court. It came that close to destroying it completely, and in fact it destroyed the existing Court and replaced it for several generations with a Court of a very different ideological complexion.

Now whatever you want to say about the current justices on the Supreme Court, they are not stupid. They have read that history, and they're not going to repeat that mistake. They're not going to destroy the Supreme Court for the sake of some abstract idea about what James Madison thought 200 years ago.

But I will close with a confession: I hope they try it. As a great president once said, "Make my day." If they try it, you know what's going to happen? It will destroy the conservative political-legal movement in this country for another generation, and I think that would be a very good thing but for the fact that Federalist Society wouldn't exist anymore and I wouldn't be invited these events anymore. That part would be very bad.

Eastman: Let me make a quick response. First, I don't recall mentioning the Obama administration at all; my criticisms were leveled at the Bush administration. And if in fact I voted Republican in the last election, the fact that I'm criticizing the prior Republican president should give one some sense that I am doing so apolitically rather than politically.

Professor Seidman talks about the general welfare. But there is nobody in this room looking at the modern language dictionary because they picked the word "welfare" by design, and "general welfare" means welfare, and that means we can do whatever we want. If we are going to have a Constitution, I will concede that it's not the intent of the drafters, but rather the intent of the ratifiers that ought to govern, because that's what the notion of a higher law that goes through the ratification process means.

The whole basis of judicial review is that the Constitution is superior to ordinary legislation because of ratification, that it represents the embodiment of the people's will and a heightened deliberation time, that it has the force of higher law against which we assess the validity of acts of Congress and of the Executive. So *we have to* figure out the intent of those who ratified it. And if by general welfare, they meant something comparable to common defense, an interest to the *whole* nation (and we find lots of evidence that's exactly what they understood those words to mean), then just because we mean something different by that phrase now *doesn't* mean that those who ratified the Constitution understood "general welfare" to be anything other than national rather than local welfare, as Hamilton said.

In *Butler*, the Supreme Court actually points that out, and it looks at whether Madison was right or Hamilton was right, and nominally sides with Hamilton. Although I actually think the history is stronger in favor of Madison's view, let me concede the point to Hamilton. Hamilton himself said that whatever limits are to be found in the Clause are not to be found in the other provisions of Article I, Section 8 (the enumerated powers) but in the Clause itself, and the only limit is that it be in the national rather than the local welfare. That's what the people who ratified the Constitution understood.

When they used the word "general," it had some import. But then the Supreme Court goes on to reaches a decision in *Butler* that actually affirms the Madisonian view. They strike down the Agricultural Adjustment Act because it didn't further any of the purposes otherwise enumerated in the Constitution. That's Madison's position, not Hamilton's. So it's a rather incoherent decision, but the final holding is that the Constitution has limits on the power of the federal government to spend. That's the actual, and still-governing, precedent; we just don't pay any attention to it any more.

Now Professor Seidman goes on to say that the stimulus spending is of course national because it addresses a national problem. But there is a difference between spending in the national or general welfare and spending on aggregate local problems. Just because I fix every pothole in the country doesn't make that local spending national, even if I distribute the money on an equal basis to every local jurisdiction. And the Whigs lost in all those elections largely because of their view on the spending power. It's just evidence that this was the common understanding at the time.

What you do when you spend money out of Washington, as Polk and Buchanan and Jackson and Madison and Jefferson all said during their campaigns and in their veto messages, is you disconnect the ability of those who benefit from those who have to pay, and encourage the profligate spending we end up getting. So if we're going to look back and think about this, not predictive of what the Court would do but as political philosophy, we have to ask, have we created a public system that is sustainable or one, going back now 60 years from the New Deal, that has in place tectonic pressures that are going to blow it apart?

If you look at federal debt as a function of GNP, the spike over the last year and a half is phenomenal. It's unsustainable, and it's going to have catastrophic consequences on our ability to govern ourselves long-term. I'm not making up some political philosophy, the ideal government. This is the government our Constitution sets out, it has limits on the ability to do such things.

Let me go to earmarks. Yes, on the non-delegation doctrine, I actually do think that Congress—there are two kinds of earmark fights. The one is that we don't have a statute in Congress; we have a committee report that nobody read that lists all the ways you're supposed to spend this money. That doesn't have the force of law, and it doesn't solve the non-delegation problem that some committee staffer is able to get it in a report. But if it's in the statute (assuming it qualifies for general welfare, which is a different problem on the non-delegation thing) that Congress wants to spend money for the bridge to nowhere, let them vote on it. Then you have the political accountability the Constitution designed. When you don't put it in the statute but let some bureaucrat in response to a letter from Congress or a phone call from a member of Congress say this is the way we want to spent it, the ability to have political accountability, which lies at the heart of the non-delegation doctrine and our whole notion of consent of the governed, goes out the window. That's why the non-delegation doctrine is there, and that's why earmarks (assuming they are not local funding, which is unconstitutional) are, on the delegation thing, actually a step in the right direction. (That will be the headline: Eastman supports earmarks. I don't; I think they're all unconstitutional. But they are better than not having them in the statute, where there is no political accountability at all.)

Finally, Professor Seidman says there's no basis in the text of the Constitution for a non-delegation doctrine. I couldn't disagree more. When the Supreme Court heard *Schechter* they rooted their decision in the Constitution, in the Vesting Clause, which says, "All legislative powers herein granted shall be vested in the Congress of the United States." That doesn't mean just that Congress passes statutes; it says if you're exercising legislative power it has to be done by Congress. The non-delegation doctrine flows directly out of that text. You can delegate the administration of legislative judgments as long as what you've delegated has a sufficiently intelligible principle as to what those policy and legislative judgments are. If you're not doing that, if you're just saying go forth and figure this out in the public interest, no legislative policy judgments have been made. The lawmaking power has been delegated, and it's no longer being exercised by Congress. That violates the Vesting Clause, because it doesn't say the legislative powers are vested in Congress and they can delegate those powers to a private actor—say, the head of the New York Federal Reserve Bank—or to an agency whose members are not removable by the president; they have to be exercised by Congress.

The delegation doctrine flows inexorably from that text, and I think it's correct. But we've completely lost sight of why it's there, for political accountability, in favor of the modern view that Congress can do all of the things we'd like government to do. I think Madison and even Hamilton would have said that's one of the reasons we limit this power to Congress: so that they can't take over three quarters of the national economy. That was tried once in the Soviet Union, and it's real hard for one guy sitting over at Treasury to figure out a $14 trillion economy and make sure he gets it right. You just can't do it. The fact that these checks on the powers of government are built into the text of the Constitution was done for the reason that the federal or public sector won't become so large that it becomes unmanageable.

Well, it has now become so large that it's unmanageable. And my plea is not whether the precedent supports it but whether it ought to. As a matter of basic political theory, the lack of accountability, of limits, is going to destroy this place if we don't start thinking in broader terms. The Founders were simply wiser on this one. The fear of an expansive government that could destroy liberty is real and we're living it right now.

Abernathy: Well, they say rules made to be broken; maybe schedules are too. I would like to give a couple minutes to Professor Seidman to respond to that, even if we are infringing a little bit on our break time. So please, Professor Seidman.

Seidman: Well, thank you. I'm not going to respond to everything Dean Eastman said because my hope is there will be some time for questions and comments from the floor. But let me make just three quick points. First, with regard to whether this is in fact an antiseptic, apolitical argument, it's true that Dean Eastman criticized President Bush. But I think he criticized because the Dean is to the right of President Bush, at least on this issue. He thinks—and I don't think he would dispute this—that TARP is a disaster, that it's leading us to become like the Soviet Union. He said as much. And he might be right about that. I don't happen to think so, but he might be. That, however, is a political view, and I just don't think you can listen to his fervor on that subject without thinking that it's influencing the way he's reading the Constitution.

On the General Welfare Clause, the Clause says—and Dean Eastman doesn't disagree—that Congress has the authority to spend money for the general welfare. Now it's true that this money is spent locally. Where else is it going to be spent? If you spend it, it's got to be spent someplace right? And that someplace, unless it happens to be on the border of California and Arizona, is going to be in a local jurisdiction. But that's very different from saying it's not spent for the general welfare. It is the belief of a majority of members of Congress and the President of the United States that the stimulus is in the general welfare, that it is necessary to restore the commerce of the United States, which has come to a halt.

Now maybe what Dean Eastman means is that he doesn't think it's in the general welfare because he doesn't think that the program's going to work. It's a mistake, a step on the road to socialism, but that leads me to my last point. This organization was founded on the principle of judicial restraint. The idea—not my idea, your idea—is that the courts aren't supposed to make judgments about whether they think particular programs are good or bad programs. They're just supposed to enforce the text of the Constitution and therefore, on your view of things, it is completely irrelevant whether TARP is going to work or not. The fact of the matter is Congress thought it was going to work, the President thinks it's working, and that's good enough—unless you can find some textual basis for saying that the Framers outlawed it. The fact that Dean Eastman doesn't like the program is not a textual basis. The Constitution says, like it or not, Congress can spend money for the general welfare.

Abernathy: So I think you sensed that there's a disagreement in our panel here, which is very healthy. It gives us an opportunity to explore this issue and feel good about it. Let's have a couple of questions. Please speak into the microphones so that we can pick up your question.

Audience Participant: I wanted to ask a question about the Whigs. It was my understanding that Lincoln kind of implemented the Whig program: massive federal spending, not just on the Civil War but on the Transcontinental Railroad, land grants, the Moral Acts, homesteading, etc. Likewise, you look at World War II period and you have the G.I. Bill, the Marshall Plan, etc. Federal spending was 45% of GDP, twice as much as today. Does that not suggest that the Whigs had it right? I guess that's a hard question directed to Dean Eastman.

To Professor Seidman, when you look at the Lincoln period, a lot of that spending was financed by Treasury issuing currency directly into circulation, spending it into circulation rather than borrowing it from a privatized central bank like the Federal Reserve and its domestic and foreign banking and bond holding clientele. So I wonder if you have any comments on this, the revenge of the Whigs, as it were.

Eastman: Yes, the Buchanan veto message that I didn't read was the veto of the first Morell Land Grant Act. Lincoln reverses course on that—I think in order to keep some of the Western states on his side in the Civil War, so I'll kind of give him a pass on the unconstitutionality. But I think the railroad is a good example of where the difference between local and national or general spending is, because in the early Congresses in the 1790s, that's exactly where they drew the line. If you wanted to build a local road, you didn't get money out of the federal treasury for it. But if it was part of the interstate postal system, that got funded. The interstate railroad system would get funded. The spur that would serve only a particular local entity would not. If you wanted to build a system of lighthouses along the Atlantic seaboard, that was in the general welfare; if you wanted to dredge the upper reaches of the Savannah River that were almost entirely of benefit to the folks of Savannah, that was not within the general welfare. Now at the margins, it's going to be a hard line to enforce, but it's not hard to enforce at either extreme. Some semblance is what they had in mind with this text of the Constitution. And it's not a claim of judicial activism for the Court to have to assess whether a statute complies with what the Constitution actually spelled out.

Seidman: Thank you. I frankly don't have a view about whether these projects ought to be funded by Treasury appropriations or by the Fed exercising its powers. The one thing I would say is if Congress doesn't like what the Fed is doing, it's not like it can't do anything about it. The Fed is a creature of Congress, and Congress could and maybe should change the law.

Abernathy: One last question. Is there one out here? Please.

Audience Participant: Dean Eastman, you mentioned something about people trying to gain standing to challenge some of these programs on a constitutional basis. I was wondering if there was actually something in the works that you know about, people trying to challenge TARP through litigation or anything like that? If so, could you talk about that?

Eastman: You know, we took a run at that five or six years ago. We took a run at this in challenging the congressional pay raises that violated the 27th Amendment, and it was knocked out on standing grounds, so I don't expect the Court is going to revisit that, which is unfortunate because it just leaves this stuff unaddressed. The Court's standing doctrine on the ability to challenge unconstitutional spending is very bad, in my view. Richard Epstein wrote a 100-page long law review article that we published in our law review at Chapman as a result of a symposium on the Spending Clause some years ago that points out that in Article III, the power of the federal courts includes powers of the courts of law and equity, and it was always part of the equitable powers to take lots of small claims where you didn't have a particularized injury, like these Spending Clause challenges would be, and allow them to be heard in the courts of equity. There's much more nuance in his article than that, but I commend it to your attention.

Abernathy: I think we have a lot of additional questions we'd ask if there were more time, and that's a good thing. The purpose of this panel is to get us thinking, stimulated, and on a very good road for the rest of the program today. Thank you very much to our panelists.

Financial Services and E-Commerce

The Wind Versus Flood Dispute: A Conflict of Interest

A Review of the Proposed Multiple Insurance Act of 2009

*By John H. Rice & Jennifer Powell Miller**

When Hurricane Katrina struck the Gulf Coast on August 29, 2005, the destruction left in her wake was impossible to measure. Wind and water leveled communities, destroyed homes, stole cherished belongings, and washed away the carefree lives of residents caught in her path. Each citizen, business, and unit of government was impacted by the scope and breadth of the disaster. As the waters receded, survivors faced the next challenge, rebuilding more than 300 years of history lost to the storm. Property owners looked to the federal government and the insurance industry to provide the means to put their lives back together, depending largely on federal disaster relief assistance and the proceeds from separate flood and wind insurance. As rebuilding and recovery efforts began, thousands of insurance claims were filed. Claims adjusters were forced to evaluate the loss suffered and make determinations as to the cause of the damage and destruction of properties—wind versus flood—determining whether the private insurance industry or federal government would have the obligation to pay. In the midst of the recovery process, allegations were made that corrupt evaluation policies adopted by several insurance companies led to the denial of many wind insurance claims. These allegations and the general retreat of the private insurance industry from offering wind coverage in coastal areas after the hurricane necessitated a reevaluation of wind and flood insurance policies.

In anticipation of another active hurricane season, the Multiple Peril Insurance Act was introduced to the House of Representatives by Mississippi Congressman Gene Taylor in March 2009.[1] This Act proposes to expand the National Flood Insurance Act of 1968[2] to include windstorm insurance coverage in addition to flood insurance coverage. The revisions would increase the availability of wind coverage and eliminate the need for insurance claims adjusters to determine whether water, wind, or some combination of the two damaged or destroyed a property; regardless of what caused the property damage, the total damage would be covered under the Act. [3]

The National Flood Insurance Act

Flooding "is generally excluded from homeowner policies that typically cover damage from other losses, such as wind, fire and theft. Because of the catastrophic nature of flooding and the inability to adequately predict flood risks, private insurance companies have largely been unwilling to underwrite and bear the risk of flood insurance."[4] "Insurers typically do not wish to provide coverage for an event that can cause significant loss to numerous properties at the same time and in the same area. Instead, they tend to insure random, yet predictable, events."[5] After widespread flooding occurred along the Mississippi River in the 1960s, insurance companies responded by raising premiums and refusing to insure at-risk properties. In 1968, Congress responded by passing the National Flood Insurance Act,[6] which offers federally backed flood insurance to homeowners, renters, and businesses in flood-prone and coastal areas that have adopted adequate flood plain management regulations. Under the National Flood Insurance Act, the National Flood Insurance Program (NFIP)[7] "was designed to stem the rising cost of tax-payer funded relief for flood victims and the increasing amount of damage caused by floods."[8]

Congress determined that "factors... made it uneconomic for the private insurance industry alone to make flood insurance available... on reasonable terms and conditions; but a program of flood insurance with large-scale participation of the Federal Government and carried out to the maximum extent practicable by the private insurance industry [would be] feasible and [could] be initiated."[9] The program was instituted through the "Write Your Own" Program, which allows the government to contract with private insurance companies to sell, write, and service[10] flood policies in their own names. The private insurance companies "receive an expense allowance for policies written and claims processed while the Federal Government [guarantees the policy] retain[ing] responsibility for underwriting losses" and sets rate and coverage limitations.[11]

> According to FEMA, [the administrator of the NFIP,] every $3 in flood insurance claims payments saves $1 in disaster assistance payments, and the combination of flood plain management and mitigation efforts save about $1 billion in flood damage each year.[12]

Wind Versus Flood

Unlike flood insurance, insurance covering wind damage is generally provided through standard homeowner insurance policies offered by private insurance companies or state-sponsored insurers, often referred to as state wind pools, or, insurers of last resort. In areas particularly prone to strong wind-based storms, however, the purchase of additional wind coverage may be required for adequate coverage.[13] In fact, in regions prone to hurricanes and flooding, it may be necessary for property owners to purchase up to three separate insurance policies to insure adequate coverage from risk.[14] One insurance company will often provide all of the policies, including a flood insurance policy on behalf of the federal government as permitted under NFIP. That insurance company when evaluating damage caused by both flooding and wind has an inherent conflict of interest when determining whether

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damage should be blamed on flooding covered by the federal government or hurricane winds covered by the insurance company itself. [15]

Following Hurricane Katrina, most insurance companies servicing the southeast faced this conflict. Inland, where wind was the only source of damage, and flooding was not a contributing factor, hundreds of thousands of claims for wind damage were paid; however, "on the Gulf Coast where winds were strongest" but flooding also contributed to damage, it has been reported that "thousands of homeowners were left with uncovered losses because these companies denied their claims for wind damage."[16] Although NFIP stipulates that any insurance "company issuing a flood policy has a fiduciary responsibility to represent federal taxpayers and to provide a proper adjustment of combined wind and water losses," allegations have been made that many insurance companies defrauded insurance "policyholders and taxpayers by manipulat[ing] insurance adjustments to blame flooding for many losses that should have been covered by the insurers' own windstorm policies."[17] Evidence that several insurance companies adopted policies that attributed all damage to flooding if there was any damage caused by flooding present,[18] and declared all damage to be the result of storm surge when it was impossible to determine from the physical evidence remaining how much damage or destruction had been caused by wind or water contributed to the claims made against insurance companies.[19] Practices like the ones described would deny "thousands of policyholders the coverage for which they had paid high premiums, allow insurers to shift liability for some wind damage to the National Flood Insurance Program, and saddle federal taxpayers with billions of dollars of repair and rebuilding costs that should have been paid by insurance."[20]

Desperate for the funding necessary to rebuild their lives, policyholders appealed claim denials and voiced concerns regarding the potential abuses of the insurance industry. The legal question that emerged from the appeals was who has the burden of proof to show how much damage was caused by wind and how much was caused by flooding. When the Louisiana district court confirmed insurance companies had the burden of proof,[21] insurance companies, with additional public pressure, were forced to take a second look at claims they had initially denied. Still insurance companies responded that they would only pay "for wind damage that [could be] substantiated."[22] The NFIP, also unable to distinguish between cause, rather than denying coverage, instead paid insurance proceeds for damage claimed, whether resulting from wind or flood.

Dependent on information provided by the private insurance companies employed under NFIP's "Write Your Own" program, "the claims information NFIP collects may not always allow FEMA to effectively oversee determinations and apportionments after hurricane events in order to ensure the accuracy of NFIP claims."[23] Generally, the data provided to the NFIP is limited to information about flooding; claims data does not include information about all perils that caused damage to the property. Even when insurance companies in the "Write Your Own" program adjust claims for wind under their own policy, as well as claims for flood under the NFIP, the information provided to NFIP is restricted to flood related records only. Without information regarding all perils that affect a property, NFIP does not have the ability to evaluate whether claims made under NFIP were limited to flood damage or to address the potential conflict of interest that may arise when "Write Your Own" insurers adjust claims for both wind and flood.[24]

Claims under the NFIP resulted in a $17 billion deficit following Hurricane Katrina. "NFIP is intended to pay operating expenses and insurance claims with flood insurance policy premiums rather than tax dollars, but it has statutory authority to borrow funds from the U.S. Treasury to keep solvent in heavy loss years."[25] In years past, the NFIP's annual premium income of $2 billion and an occasional temporary loan from the Treasury have allowed the program to function self-sufficiently.[26] By March 2006, however, the NFIP was forced to increase its borrowing authority with the Treasury from $1.5 billion to $20.8 billion.[27] If, as evidence suggests, private insurance companies allocated loss that should have been covered under privately-insured wind policies to the NFIP, arguably a portion of the deficit consists of a federal bailout of sorts to the private insurance industry, similar to the banking industry's current bailout under the Troubled Assets Relief Program (TARP). This bailout caused taxpayers to shoulder some of the costs that resulted from the risk the industry took when it decided to provide wind coverage in high-risk areas and to subsidize the premiums the industry already received from policyholders.

Problems with wind insurance coverage did not stop with the denials of wind damage claims or their misappropriation to the NFIP during the recovery process. As homes and businesses were rebuilt, property owners attempting to insure their property against future loss found that insurance companies, adverse to the potential repeated risk, had "increased premiums on existing policies, canceled existing policies or have stopped writing new policies altogether."[28] Often a property owner's only option for wind coverage is a state wind pool, the insurer of last resort.[29]

Proposed Multiple Peril Insurance Act

The proposed Multiple Peril Insurance Act presents an alternative for property owners allowing them to purchase comprehensive insurance, including both windstorm[30] and flood coverage in one policy. With a combined policy, policyholders and insurers would avoid the wind-versus-flood dispute, policies would be more widely available, and risk would be spread geographically rather than centralized in state wind pools or in a few private insurance companies.[31]

The proposed Act would make the following revisions to the National Flood Insurance Act:

1. Provide an Option to Purchase Multiple Peril Coverage or Separate Windstorm Coverage

Depending on availability by area, the Act would provide the option to purchase "multiperil coverage" from the federal government which would provide "optional insurance against loss resulting from physical damage to or loss of real property or personal property related thereto located in the United States arising from any flood or windstorm"[32] or, if a policyholder has

purchased flood insurance, the option to purchase separate windstorm coverage which would provide "optional insurance against loss resulting from physical damage to or loss of real property or personal property related thereto located in the United States arising from any windstorm."[33]

2. Require Adoption of Wind Mitigation Measures

The availability of the optional multiperil or separate windstorm coverage would be dependent on an area's adoption of wind mitigation measures. The optional coverage "may not be provided in any area (or subdivision thereof) unless an appropriate public body shall have adopted adequate mitigation measures (with effective enforcement provisions) which the Director finds are consistent with the criteria for construction described in the International Code Council building codes relating to wind mitigation."[34]

3. Deny Duplicative Coverage

The Act provides for a "prohibition against duplicative coverage."[35] No structure may ever be covered by multiperil coverage and flood insurance coverage at the same time.[36] Separate windstorm coverage may only be provided with respect to a structure that is covered by flood insurance and only during the period of time a structure and personal property is covered by flood insurance.[37]

4. Require Evidence of Loss Resulting from Windstorm or Flood

Neither option requires that a distinction be made between damage caused by flooding and damage caused by wind. Under multi-peril coverage, evidence must be shown that loss resulted from flooding or windstorm, but it is unnecessary to distinguish or identify which was the specific cause of the loss. Separate windstorm coverage, however, will cover losses only from physical damage resulting from windstorm, but will "provide for approval and payment of claims under such [windstorm] coverage or under the flood insurance coverage required to be maintained... upon a determination that such loss from windstorm or flooding, respectively, but shall not require for approval and payment of a claim that the insured distinguish or identify the specific cause of the loss, whether windstorm or flooding."[38]

5. Set Premium Rates on an Actuarial Basis

Multi-peril and separate windstorm coverage shall be made available for purchase for a property only at chargeable risk premium rates. Rates for coverage will be actuarially based for the type and class of properties covered. Risks will be invoiced and accepted actuarial principles, operating costs, allowance and administrative expenses will be factored and considered to determine the real cost of the risk.[39]

6. Increase the Amount of Coverage Available for Residential and Nonresidential Properties

The amount of insurance coverage shall not "exceed the lesser of the replacement cost for covered losses or the following amounts":

(a) For Residential Structures—(i) $500,000 for any single-family dwelling; (ii) for any structure containing more than one dwelling unit, $500,000 for each separate unit; and $150,000 per dwelling unit for (a) any content related to the unit; and (b) any necessary increases in living expenses incurred by the insured when losses from flooding or windstorm make the residence unfit to live in.

(b) For Non-Residential Structures—(i) $1,000,000 for any single structure; and (ii) $750,000 for—(a) any contents related to such structure; and (b) in the case of any nonresidential property that is a business property, any losses resulting from any partial or total interruption of the insured's business caused by damage to, or loss of, such property from flooding or windstorm, except that for purposes of such coverage, losses shall be determined based on the profits the covered business would have earned, based on previous financial records, had flood or windstorm not occurred.[40]

7. Limit Amount of Coverage Available for Separate Windstorm Coverage

The aggregate amount of windstorm coverage plus the amount of required flood insurance coverage together shall not exceed the applicable coverage limit for the property.[41]

Considerations

Following disaster, all those affected have a new respect for risk, an understanding of limitations, and a desire to improve upon and protect that which they have struggled to rebuild. When the private insurance industry had a difficult time responding in an efficient and effective manner to the demands of a disaster of the magnitude of Hurricane Katrina, expectedly the industry chose to recoil from that risk. It is the nature of the industry that "[p]rivate insurers do not want to be exposed to a situation that threatens many properties in the same area to the same peril at the same time…. [therefore after Hurricane Katrina] most 'admitted' insurers have no appetite for wind coverage along the Gulf Coast."[42] Insurers may shy from the risk, but the need for adequate insurance coverage in at-risk areas remains. As was the case when the National Flood Act was enacted, although private industry has the means to provide the necessary coverage,[43] considering all factors, it is considered by supporters of the Act "appropriate for the Federal government to step in and provide some reasonable form of relief, be it temporary or permanent."[44]

The intent of the Act is clear—to provide wider and more economical insurance coverage for a greater number of people. There are, however, trade-offs associated with the Act's adoption. The impact of the Act is a cause of concern for the private insurance industry. In response to this Act, and similar previous bills introduced in Congress, the industry has issued statements in opposition to federally backed comprehensive flood and wind insurance coverage. Trade and interest groups state that there is already adequate wind coverage to protect homeowners available either through the private insurance industry or state wind pools.[45] Other groups believe that combined coverage is 'misguided and would needlessly displace the private market, [and] disrupt existing state funds," adding an "additional burden on a program [National Flood Insurance Program] that is already in dire financial straits."[46] Displacement of the coastal private insurance industry in particular could result in job loss as well as loss of private industry insurance premiums and state

tax premiums.[47] In addition, the industry claims that enactment of the Act would expand the reach of the government and could hurt the national economy, the affordability of insurance, and be "unnecessarily costly to taxpayers," who would be forced to shoulder the cost of coverage for people who live in high-risk places.[48]

Although wind coverage is currently available through remaining private insurance companies and state wind pools, the multi-peril coverage option does more than just provide a property owner with wind insurance coverage. It eliminates the wind-versus-flood dispute that created tremendous hardship for property owners and NFIP alike following Hurricane Katrina. Under a multi-peril policy, evidence must be shown that damage resulted from wind or flood but it is not necessary to distinguish which was the specific cause of loss allowing claims to be resolved more quickly. With all coverage being provided by the federal government, concerns regarding shifting of liability and manipulation of adjustments would no longer exist. It is possible, however, depending on the state, that the Act, although covering wind and flood, could cover fewer perils than a NFIP policy combined with a state wind pool policy. If, in order to ensure that there is not a gap in coverage, a property owner had to purchase an additional policy in the private insurance market to maintain an adequate amount of coverage the advantage of the Act would be counteracted and similar problems relating to determination of cause and apportionment would result.

Rather than excluding the private insurance industry from the market, the option of purchasing combined wind and flood insurance coverage is intended to "stabilize the insurance markets in coastal areas where insurance companies have stopped writing new policies."[49] Insurance companies could return to coastal markets to sell homeowners' insurance without taking on the hurricane risk that they would like to avoid and could sell, write, and service the multiperil policies on behalf of the government, like under the current National Flood Insurance Act, and receive a commission for selling policies and reimbursement for reasonable administrative expenses.[50] Relieving the burden of providing wind coverage, the private insurance industry would have an incentive to continue writing policies in coastal areas.[51]

The Act would resolve issues relating to availability of wind policies and reduce the risk to private insurance companies, but could potentially expose the federal government and taxpayers to more significant loss. As with state wind pools, it is likely that the Act will primarily insure high-risk property. Although risk would be spread across the country, the level of risk will likely not vary. Such uniformity in risk could result in a higher proportion of the number of claims in comparison to the number of policyholders for NFIP than for private insurers who could spread the risk not only geographically, but also across varying levels of risk. Under the Act, this risk of loss would be entirely born by the federal government and subsequently passed on to taxpayers. The private insurance industry, however, is able to hedge risk of loss by obtaining reinsurance which provides insurance coverage against catastrophic loss for insurance companies. [52]

Setting premium rates to cover all expected loss for wind and flood would require "sophisticated determinations."[53] Implementation of the Act would require the adaptation of "existing administrative, operation, monitoring, and oversight processes and establish[ment of] new [processes] to accommodate wind coverage," determination of appropriate building codes "address[ing] constitutional issues related to federal regulation of state and local code enforcement," expansion of the "Write Your Own" program, and the agreement and adoption by communities of international building codes and mitigation measures.[54] However, much of the NFIP debt from Hurricane Katrina was due to the failure of levees and floodwalls in New Orleans, Louisiana, where the flood maps and premiums assumed that the levees would hold. Their failures increased NFIP's liabilities by billions of dollars. Furthermore, Hurricane Katrina produced an unprecedented storm surge, which made the flood damage much more severe than expected. Comparatively, setting premiums based on the probability and severity of hurricane winds is much easier than predicting storm surge or levee performance.

Economist Lloyd Dixon of the RAND Corporation paints a federal insurance pool covering hurricanes and other major disasters as a benefit to taxpayers: "[T]he government is not subject to the private-sector factors that produce large swings in premiums around expected loss in private insurance markets. Thus, compared with the private sector, government should be able to set insurance prices closer to expected loss for hurricanes and other catastrophic risks, and keep those prices closer to expected loss over time."[55] The premiums for multi-peril policies would be set "according to risk by using the same data available to insurance companies and state wind pools. Once the risk is estimated for a location, the premiums for specific properties would be set by adjusting for construction methods, foundation, wall and roof types and other building characteristics."[56] To the extent those objectives could be accomplished, reasonable, accurate premiums and comprehensive insurance coverage could be expected to relieve property owners and taxpayers of the burden of relying on and providing federal disaster relief assistance.[57] For instance, after Hurricane Katrina, even in cases in which disputes over wind and flood eventually were resolved, taxpayers paid for FEMA trailers, housing vouchers, grants, subsidized loans, tax deductions, and other disaster relief during the time required to resolve such disputes. Lengthy insurance disputes delay the recovery of entire communities and prolong the reliance of local governments and businesses on disaster payments, loans, and tax relief. The Homeowners Assistance Program in Mississippi, the Road Home program in Louisiana, and other federal assistance programs paid billions of dollars in grants to assist tens of thousands of homeowners who had wind coverage, but did not have flood coverage for the portion of their loss that was attributed to flooding. The Multiple Peril Insurance program should increase the number of policies and the amount of flood coverage in coastal areas so that more future hurricane losses will be covered by insurance premiums. Coastal residents who are not required to purchase flood insurance, but do have some flood risk from an extreme event, should be more likely to buy one policy that will cover hurricane damage than to buy separate policies for wind and flood risks.

Although a federal program might be at an advantage once the Act is in place and risk of loss for specific areas can

be estimated over time, in the early years of implementation determination of the future cost of loss would be difficult. Funding of the Multiple Peril Insurance program would depend on the amount of participation in the program and the risk level of those participants as estimated by existing data, and could result in higher premiums than those that could be offered by private insurance companies or state wind pools. Unlike private insurance companies who "can generally supplement premium income with investment income on funds that they hold" and rely on competition to promote a more efficient and profitable market, the Act will rely solely on premiums to fund the program.[58]

By creating "workable methods of pooling risks, minimizing costs and distributing burden equitably among policyholders and taxpayers,"[59] the Act proposes one viable option for increasing availability of wind policies and remedying the wind-versus-flood dispute prior to any future disasters.

Endnotes

1 The Multiple Peril Insurance Act of 2009, H.R. 1264, 111th Cong. (2009). The bill was introduced March 3, 2009 by Congressman Gene Taylor along with 14 bipartisan co-sponsors and referred to the House Financial Services Committee. Congressman Gene Taylor is a resident of Bay Saint Louis, Mississippi.

2 42 U.S.C. § 4001 et seq. (1997).

3 Gene Taylor, "Water/Wind Dispute: The Eye of the Insurance Storm," http://www.taylor.house.gov/index.php?option=com_content&task=view&id=306&Itemid=36 (last visited Apr. 15, 2009).

4 National Flood Insurance Program: Hearing Before the S. Banking, Housing and Urban Affairs Comm., 109th Cong. (2006) (statement of David M. Walker, Comptroller General of the United States Government Accountability Office Testimony) [hereinafter Walker Testimony]. *See* Insurance Exposed by 2005 Hurricanes: Hearing Before the Subcomm. on Oversight and Investigations of the H. Financial Services Comm. and Subcomm. on Management, Investigations and Oversight of the H. Homeland Security Comm., 110th Cong. (2007) (statement of Orice M. Williams, Director of Financial Markets and Community Investment U.S. Government Accountability Office) [hereinafter Williams Testimony].

5 Flood Insurance: Hearing Before the Subcomm. on Housing and Community Opportunity of the H. Financial Services Comm., 110th Congress (2007) (statement of W. Anderson Baker, III, President of Gillis, Ellis & Baker Inc.) [hereinafter Anderson Testimony].

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8 Flood Insurance, http://www.iii.org/media/hottopics/insurance/flood/ (last visited Apr. 15, 2009).

9 42 U.S.C. § 4001(b).

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16 *See* Gene Taylor, *Federal Insurance Reform After Katrina*, 77 Miss. L.J. 783, 784 (2008).

17 *Id.* at 786 (citing 44 C.F.R. § 62.23(f) (2005)). *See* Gene Taylor, Multiple Peril Insurance Act of 2009: The Facts, http://www.taylor.house.gov/index.php?option=com_content&task=view&id=296&Itemid=36 (last visited Apr. 15, 2009); State Farm: We're Paying Wind Damage Claims (Apr. 7, 2006), www.insurancejournal.com/news/southeast/2006/04/07/67138.htm.

18 *See* Taylor Testimony, *supra* note 10, at 4 ("State Farm, Allstate, Nationwide, USAAA and other insurers adopted procedures that, *a priori*, attributed all damage in the surge area to flooding and then forced homeowners to prove otherwise.")

19 *See* Taylor, *supra* note 16, at 783 (indicating damage to a second story of a home was caused by water although there were severe wind for 4 hours prior to water arriving).

20 Taylor, *supra* note 16, at 786 (citing 44 C.F.R. 62.23(f) (2005)). *See* Gene Taylor, Multiple Peril Insurance Act of 2009: The Facts, http://www.taylor.house.gov/index.php?option=com_content&task=view&id=296&Itemid=36 (last visited Apr. 15, 2009). *See, e.g.*, State Farm: We're Paying Wind Damage Claims (April 7, 2006), www.insurancejournal.com/news/southeast/2006/04/07/67138.htm.

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22 State Farm: We're Paying Wind Damage Claims, *supra* note 17.

23 U.S. Gov't Accountability Office, No. GAO-08-28, National Flood Insurance Program: Greater Transparency and Oversight of Wind and Flood Damage Determinations Are Needed 4 (2007).

24 *See* Williams Testimony, *supra* note 4. *See also* U. S. Gov't Accountability Office, No. GAO-07-991T, National Flood Insurance Program: Preliminary Views on FEMA's Ability to Ensure Accurate Payments on Hurricane-Damaged Properties 2, 5 (2007); NFIP New Processes, *supra* note 11, at 7 (During Hurricanes Katrina and Rita, FEMA also adopted expedited methods for claims processing that reduced the claim information received by FEMA further, allowing "claims payments to policy limits without site visits by certified flood claims adjusters or... the use of models that paid claims based on the square footage of the home and general classification by adjusters of the quality of its building materials.").

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26 *See id.*

27 *Id.* "FEMA projects that when all claims are settled, claims from NFIP policyholders who suffered flood damage from Hurricanes Katrina and Rita will total more than $20 billion. In contrast, the NFIP reports that from its

inception in 1968 until August 2005, it paid a cumulative total of about $14.6 billion in claims." *Id*. at 14.

28 Taylor Introduces Multiple Peril Insurance Act, http://www.wlox.com/Global/story.asp?s=9934553 (last visited Apr. 15, 2009). *See* Taylor, *supra* note 16, at 788.

29 *See* Taylor, *supra* note 16, at 788.

30 Windstorm refers "any hurricane, tornado, cyclones, typhoon or other wind event." H.R. 1264 § 6(3).

31 "I have proposed the idea that you can buy your flood insurance from the federal government—that stays as is. And you can buy an option of your flood insurance to cover wind. So that whether the wind did it or the water did it, if you come home to a slab, or if you come home and your home is substantially damage or destroyed, it doesn't matter. If you built it the way you are supposed to, if you paid your premiums and the storm gets it, you're going to get paid. You don't have to hire a lawyer. You don't' have to hire an engineer. You don't have to wait years to get the check that you should have gotten within days." Gene Taylor, "Anti-Concurrent Causation: Insurer's Hidden Weapon Against Homeowners," http://www.taylor.house.gov/index.php?option=com_content&task=view&id=294&Itemid=36 (last visited Apr. 15, 2009). *See also* "Protecting America's Home & Business Owner. Protecting America's Taxpayer," http://slabbed.wordpress.com/2009/03/04/hr-1264-one-policy-premium-one-claims-adjuster.

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34 *Id.* at § (c)(2).

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36 *Id.*

37 *Id.*

38 *Id.* at § (c)(4)(A)(ii).

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40 *Id.* § (c) (7)(A).

41 *Id.* § (c)(7)(B).

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43 Congressman Taylor indicated that "there's nothing in existing regulations stopping insurers from creating multi-peril policies right now by selling flood coverage. The fact is that the private sector doesn't want that job." Anderson Testimony, *supra* note 5.

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45 Deborah Barfield, Taylor pushes insurance for wind damage, http://www.hattiesburgamerican.com/apps/pbcs.dll/article?AID=2009903230312 (last visited Apr. 15, 2009). "By spreading risk geographically, a federal program would result in lower risk than [a state pool].... Insurance works best when the insured pool can spread the risk. A federal pool spread over all coastal states would not have a high percentage of its properties hit at one time. On the other hand, a single state pool with concentrated risk could have losses to most of its properties after a major hurricane." Taylor, *supra* note 16, at 791.

46 Arthur D. Postal, "Multi-Peril Bill Reintroduced; Industry Opposed," (March 4, 2009), http://www.taylor.house.gov/index.php?option=com_content&task=view&id=427&Itemid=36. *See* Barfield, *supra* note 42.

47 Property Casualty Insurers Association of America, Calls for Federal Windstorm Coverage are Misguided (July 21, 2008), http://www.pciaa.net/publish/web/webpress.nsf/lookupwebcontent/8195913062b7749b8625748d0051e80/$FILE/WindCoverage072108(2).pdf. PCI believes that the following negative consequences could result from putting in place the Multi-Peril Insurance Act: "(a) 65,000 jobs could be displaced if the bulk of the property insurance marketplace purchased the multi-peril coverage, (b) loss of more than $38 billion in private industry insurance premiums, (c) $1 billion in lost state premium tax revenue and more than $1 billion in individual state and federal income tax revenues, (d) irreparable damage to the private coastal insurance market would result from such a program being enacted and (e) availability of reinsurance may also be adversely affected, because if wind exposure shifts from the private marketplace to the NFIP, reinsurers may be less willing to invest capital in the US market." *Id.*

48 Postal, *supra* note 46; David A. Sampson, *Don't Add Wind Coverage to U.S. Flood Insurance Program*, TheHill.com (Sept. 16, 2008), http://thehill.com/letters/dont-add-wind-coverage-to-u.s.-flood-insurance-program-2008-09-16.html.

49 Taylor, *supra* note 16, at 790-91.

50 *Id*.

51 *Id*.

52 U.S. Gov't Accountability Office, No. GAO-08, 504, Natural Catastrophe Insurance: Analysis of a Proposed Combined Federal Flood and Wind Insurance Program 4, 24 (2008) [hereinafter Analysis of Proposed Combined Insurance].

53 *Id.* at 3.

54 *Id.* at 9-10.

55 Taylor, *supra* note 16, at 791 (citing Lloyd Dixon, James W. Macdonald & Julie Zissimopolous, Commercial Wind Insurance in the Gulf States: Developments Since Hurricane Katrina and Challenges Moving Forward 3 (2007)).

56 *Id.* at 791-92.

57 *Id*. at 790. After Hurricane Katrina, storm survivors relied on federal disaster assistance in the form of FEMA trailers, subsidized loans, homeowner repair grants, and special tax deductions rather than being able to depend on the insurance coverage they had paid for. *Id.*

58 Analysis of Proposed Combined Insurance, *supra* note 49, at 29.

59 *Id.* at 8.

Free Speech & Election Law

No Cure for Corruption: Public Financing under Constitutional Constraints

*By David M. Mason**

Barack Obama's victory over John McCain was due in no small part to his spending advantage.[1] He gained that advantage by collecting private donations, rather than accepting a public grant accompanied by a spending limit. Yet Obama felt compelled to defend his decision by calling for "reform" of a system he described as broken and claiming his would be "first general election campaign that's truly funded by the American people."[2] Some of Obama's supporters and a chorus of "reform" organizations continue to advocate "updating" the public financing system.[3]

As John McCain discovered, the biggest threat to public financing is competition from the private sector. Since *Buckley v. Valeo* declared that the government could not prohibit private fundraising, public financing schemes have had to compete with a parallel system of private financing.[4] While the initial subsidies in the Presidential public financing program were sufficiently rich to induce candidates to accept limits on spending and private contributions, over time private financing methods improved and public financing became less attractive. Rather than increasing subsidies, public financing advocates initially reacted by attempting to impose new limits or burdens on private financing.[5]

Trends in technology and constitutional interpretation are likely to continue, however, to make public financing—at least that associated with spending limits—unattractive. Low-cost, high-volume Internet fundraising has overwhelmed spending limits associated with traditional public financing schemes. At the same time, courts have clarified that public funding schemes may not coerce or handicap privately-funded candidates, for instance by giving advantages to publicly-funded candidates on account of an opponent's private fundraising. Further, courts have increasingly limited the rationales sufficient to justify limits on private political financing, and therefore expanded the scope and volume of private financing. The Supreme Court's recent order for rehearing in *Citizens United v. FEC* gives a strong hint that the Court will extend this trend.[6] Reform proposals have finally adapted with increasing subsidies and by increasing or eliminating spending limits.

In an era of broad-based Internet fundraising, public financing begins to look like a cure in search of a disease. Even worse, the super-subsidies required to compete with Internet-enabled fundraising offer powerful inducements to the fraud and corruption that campaign finance laws are purportedly intended to prevent. A campaign finance scheme enabling corruption is not a cure worse than the disease: it is a contagion masquerading as a cure.

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It's the Doctrine, Dummy

An understanding of the public financing advocates' dilemma must begin with a review of the Supreme Court's increasingly structured campaign finance jurisprudence. That review begins with *Buckley v. Valeo*.[7] While *Buckley* established that all campaign activity was protected by the First Amendment, the *per curiam* opinion was notably imprecise about what standard of review applied.[8] *Buckley* failed to utilize any traditional form of constitutional review: strict, intermediate or rational basis scrutiny, settling instead for "exacting," with little further description.[9] *Buckley* then applied this "standard" separately and with varying results to campaign spending (generally not limited), contributions (subject to limits) and mandatory disclosure (generally, though not always permissible). This has led some subsequent cases to refer simply to "*Buckley's* standard," without, however, adding any content to that description.[10]

This doctrinal imprecision has led to a confused welter of decisions, some appearing suspiciously outcome-based. The Massachusetts Citizens for Life, for instance, we permitted to expend corporate funds on candidate advocacy because they were small (deriving funds from activities such as bake sales) and ideologically motivated.[11] The Michigan Chamber of Commerce, on the other hand, was muzzled because it was too big, and might have had the wrong sort of motives.[12] Because no First Amendment principle distinguishes large from small organizations or justifies probing a speaker's motives, the *Austin* court rested its holding on alleged abuse of the corporate form: the unfairness of deploying resources gained in the economic marketplace in the political arena.[13] Yet earlier in *Buckley* and subsequently in *Davis v. FEC*,[14] the Court insisted that wealthy individuals, most of whom presumably obtained their riches in the economic marketplace, have an absolute First Amendment right to deploy that wealth in political campaigns.

Similarly divergent outcomes have emerged in contribution limit cases. In *Nixon v. Shrink Missouri Government PAC*, the Court decided, based on a "sliding scale" allegedly derived from *Buckley*, that contribution limits as low as $250 for certain offices were permissible.[15] Yet in *Randall v. Sorrell*, the Court determined $25 was below the constitutional minimum.[16]

What emerges is not a single "Buckley" standard of review, but three standards: strict scrutiny for limits on political speech and spending, "close" or "exacting" scrutiny for disclosure requirements,[17] and a third standard for contribution limits. The contributions analysis begins with a requirement for a compelling government interest, apparently identical to the "strict scrutiny" analysis. Yet the cases readily find that interest in the objective of preventing corruption or the appearance of corruption, with little real examination, and no requirement for any evidentiary record.[18] However, courts have failed to apply

the "narrow tailoring" prong representing the other half of strict scrutiny to contributions, claiming to possess no judicial "scalpel to probe…."

In practice, prior to *Randall*, this meant the courts simply deferred to legislative judgment. While *Randall* drew a line against this deference to legislatures, it provided little doctrinal or theoretical guidance for future cases. The *Randall* analysis rested on a detailed examination of the complex Vermont contribution limits regime, which was in many respects not terribly different from the Missouri law the court had upheld in *Shrink*. One difference cited, for instance, was the lack of an indexing provision in Vermont, a rather narrow basis on which to find a distinction of constitutional import. [19]

To the extent *Randall* had a doctrinal basis, it rests in the requirement that any contribution limit cannot be set so low as to prevent a candidate from amassing resources sufficient for a campaign.[20] In addition to providing no yardstick for "sufficiency," this formulation appears more akin to a balancing test (the government's *interest* in preventing corruption balanced against the candidate's *interest* in sufficient campaign funds) than a formulation designed to protect constitutional *rights*.

Strict Scrutiny

Against this confused background, the enduring contribution of *FEC v. Wisconsin Right to Life* may be its deployment of two magic words: "strict scrutiny," followed by a classic statement that this standard required a compelling government interest and a remedy narrowly tailored to achieving that interest.[21] *WRTL* cited numerous campaign finance cases holding that a "compelling interest" was necessary to justify burdens on political speech, including *Buckley*, though the cited section in *Buckley* did not use this term. Other than *Austin*, however, none of the cited cases used the classic (and often fatal) "narrow tailoring" requirement, instead using terms such as "sufficiently related" or "closely drawn." Whatever distinctions may be discernable among these terms in plain English, the studied refusal, prior to *WRTL*, to use the phrase strict scrutiny or to couple the two parts of that test left the campaign finance field open to disparate standards of interpretation.

The significance of *Davis* amidst the jumble of scrutiny tests is twofold. First, *Davis* defined certain devices styled as contribution limits to be, in effect, limits (or at least burdens) on spending, subjecting them to strict scrutiny under *WRTL*. In this category are the various increased contribution limits for one candidate, based on another candidate's spending that were directly at issue in *Davis*, and, by its favorable citation of *Day v. Holahan*, increases in limits triggered by independent spending opposed to a candidate.[22] Notably, the devices at issue in *Davis* and *Day* were not limits on a candidate's or interest group's spending, merely burdens.

Second, *Davis* clarified that any such burden required compelling justification, and effectively reiterated a long series of precedents holding that preventing corruption was the only compelling justification for burdening private financing. *Davis* rejected several weakly proffered government interests including informational interests, or saving candidates' time. The opinion was particularly harsh in criticizing the purported interest in equalizing candidates' resources. Far from being compelling, the "leveling" argument was described as "ominous" and "dangerous."[23]

Given that *Davis* explicitly undermined the rationale of *Austin*, and cited Justice Kennedy's dissent in that case, the *Citizens United* order expressly asking for briefing on whether *Austin* should be overturned has been greeted by many as a fait accompli.[24]

The Death of Public Financing

The likely fatal implications of *Davis* for state "clean elections" schemes was discussed here in the last issue.[25] For the Federal Presidential public financing system, and proposals to revive it, the effects are more subtle, though in the end perhaps no less fatal. The nub of the problem is that Federal public financing schemes, like most of their state counterparts, historically have been coupled with limits on private contributions to, and overall spending by the publicly-financed candidates. *Davis* foreclosed coercive efforts to limit private spending in competition with public funding. Moreover, by undermining the rationale for limitations on corporate spending, *Davis*, and now *Citizens United,* threaten public financing schemes with even greater competition from voluntary, private spending.

The Presidential public financing system consists of two programs. During primaries candidates are offered matching funds of up to $250 from each contributor. Candidates who accept the finds are subject to a number of requirements, most significantly a limit on overall spending. In the general election major party candidates may elect to receive a grant intended to fully fund the campaign, in return for eschewing all private funding. Between 1976 and 1996 virtually every presidential candidate opted in to both programs.

Since 2000 candidate participation in the public funding programs has eroded precipitously. In 2000 George W. Bush chose to forgo matching funds in the primary, calculating that he could raise far more in private funding, even at the cost of the $250 match. In 2002 the McCain-Feingold legislation doubled the contribution limit from $1,000 to $2,000 and indexed it for inflation. McCain-Feingold did not, however, alter the presidential public funding laws. The effect was to reduce the value of the primary matching funds in comparison to the maximum allowable contribution by half from 1:4 to 1:8. By the next Presidential election the ratio will fall further to around 1:10 due to indexing of the contribution limit. During the same period candidates, were able to harness Internet fundraising to increase significantly the number and overall value of smaller donations. As a result, all of the strongest candidates opted out of the primary matching fund system in 2004, and only the weakest candidates accepted matching funds in 2008. Also last year Barack Obama chose to decline the general election grant, and was able to able to marshal $375 million for the general election, overwhelming the $84 million public grant paid John McCain.[26] Based on this experience McCain declared public financing "dead."[27]

Reviving the Dead: Will Subsidies Do?

The death of the presidential public funding system has produced, naturally, calls to revive it. Revival requires, it seems more money: a far richer regime of subsidies to induce

candidates to accept public funding. Leaving aside the wisdom or political appeal of these proposals, the constitutional question raised by these subsidies is whether they are so rich as to encourage the very corruption the prevention of which is the constitutional and political *raison d'etre* for the very existence of public financing.

Davis affected the leading proposal to alter the presidential public financing program nearly as dramatically as it upset state "clean elections" laws. The Presidential Funding Act of 2007 proposed to increase spending limits and subsidy levels for publicly-funded candidates in presidential primaries based on spending by their privately-financed opponents. For the general election, the bill would have doubled, from $100 to $200 million the grant for candidates facing privately-funded opponents who raised more than $300 million for the primary and general elections combined.[28] *Davis* clearly placed such burdens on private spending out of constitutional bounds.[29]

Sponsors of the public financing scheme for Congressional elections have reacted to this constitutional squeeze by giving up on explicit spending limits altogether.[30] Prior versions of the Congressional public financing legislation, like the Presidential scheme, employed subsidies to induce candidates to accept spending limits.[31] Since candidates are apparently no longer willing to accept this bargain, the spending limits are dropped, and the subsidy regime is sweetened for no purpose other than to induce candidates to accept the subsidies. The current version of the "Fair Elections Now Act" would provide over $12 million in subsidies to a Senate candidate for the primary and general elections in a medium-sized state in return for, and in addition to, approximately $2 million in private contributions.[32] Advocates of presidential public funding have not quite given up on spending limits, though one proposes increasing the limit to over $500 million for the combined primary and general election campaigns.[33]

A key feature of both the Presidential Funding Act and the Fair Elections Now Act is a matching fund system providing a government grant four or five times the value of small contributions ($100 in the congressional scheme, $200 in the presidential). While the funding scheme could reach a similar result in terms of value to a candidate by retaining a 1:1 match but increasing the matchable component to $1,000 or more, public financing advocates have another aim. They seek to make a $200 contribution worth as much to a candidate as a $1,000 or larger contribution. Public financing advocates seek, in other words, to equalize the financial voices of smaller and larger donors. This purpose may be permissible under prevailing jurisprudence as an exercise of Congress's spending or welfare powers, but after *Davis* it does not represent an interest sufficient to infringe upon candidates' or contributors constitutional rights.[34] Indeed, such an ominous and dangerous policy might even exceed the broad contours of the spending clause as no consistent with the general welfare.

Corruption on Steroids

The problem with multiple matching schemes is that they will inevitably, and substantially, increase corruption in the campaign finance system. The very existence of campaign contribution limits has sparked a variety of permissible efforts to avoid them (such as independent spending by a candidate's supporters), controversial efforts to supplement them (such as with political party soft money or cost sharing), and plainly illegal efforts to evade them. The most common form of evasion is for a wealthy donor to reimburse employees, associates, friends and relatives for making contributions to campaigns. An Ohio coin dealer admitted to giving $45,400 illegally in such a scheme and went to jail.[35] In other instances, corporations reimburse employees for campaign donations. Little Rock attorney Tab Turner admitted to reimbursing approximately $10,000 in contributions from employees and relatives and paid a $50,000 fine.[36]

The era of Internet fundraising appears to have made such outright lawbreaking easier to execute and more difficult to remedy. The Obama campaign, for instance, initially accepted thousands of small contributions from fictitious donors with improbable names such as Doodad Pro ($17,130) and Good Will ($11,000).[37] Unlike Turner, who left a trail of checks and paper credit card receipts, Mr. Pro and Mr. Will left only virtual tracks and apparently received no punishment other than getting their money back.

The presence of matching funds provides a dramatically increased incentive for conduit contributions: the returns of the illegal scheme are increased by the government match. Perpetual candidate Lyndon LaRouche had repeated run-ins with the FEC over improper efforts to establish or increase eligibility for matching funds.[38] Some candidates appear to have decided to campaign for the Presidency in part in order to multiply the value of otherwise legitimate contributions through the primary match fund program. These cause-oriented candidates simply transferred permanent staffs and fundraising efforts of their political organizations over to a presidential campaign in order to get the benefit of a government subsidy (along with the notoriety of running for President).

With government subsidies of 400 or 500% of small contributions, it is all too easy to imagine an ACORN-like scheme in which an army of street-level fundraisers are paid bounties to find small donors with no questions asked. Like walking-around money on election day, campaigns would not be paying people to contribute, just paying people to find contributors. And if the contributors they found happened to be family members, friends, and neighbors, what could be more natural?

Even absent out-and-out fraud, professional fundraising organizations would find the magnetic attraction of a 4:1 match impossible to resist. Certain causes are capable of raising millions of dollars a year through direct mail and phone bank efforts, but end up netting only pennies on the dollar.[39] Under a 4:1 public financing scheme, such organizations can simply anoint a prominent spokesman as a candidate, and turn a big profit. Supporters of public financing might well regret loosing the voices such a scheme would equalize.

If it has caused campaign reformers to abandon efforts to stifle political debate through spending limits, *Davis* represents a great step forward. Because pure (subsidy-only) public financing schemes do not limit rights, they are less likely to suffer judicial invalidation. For this reason it is all the more important for policymakers to consider the corruption-inducing aspects of

massive government subsidies for political movements before embracing them as a cure for what ails the political system.

Endnotes

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3 The Presidential Public Financing Reform Project, for instance, including Common Cause, League of Women Voters, Public Citizen, Public Campaign US PIRG and Democracy 21 describes its goal as to "reform the system so that it is adequately funded and can serve its original goals." http://www.commoncause.org/site/pp.asp?c=dkLNK1MQIwG&b=4773833.

4 424 U.S. 1 (1976).

5 The Bipartisan Campaign Reform Act of 2002 ("McCain-Feingold"), for instance attempted to impose new limits on political party spending in support of Presidential nominees, and on political party financing (much of which was seen as associated with presidential campaigns). State "clean campaign" statutes, which also attempt to impose burdens on private financing competing with public funding are discussed below.

6 Order Number 08-205, http://www.supremecourtus.gov/orders/courtorders/062909zr.pdf.

7 424 U.S. 1.

8 Nixon v. Shrink Missouri Government PAC, 528 U.S. 377, 387 (2000) ("Precision about the relative rigor of the standard to review contribution limits was not a pretense of the *Buckley per curiam* opinion.").

9 *Id.*

10 *Id.* at 387; McConnell v. FEC, 540 U.S. 93, 103 (2003); Randall v. Sorrell, 548 U.S. 230, 266 (2006) (Thomas concurring).

11 FEC v. MCFL, 479 U.S. 238, 242 (1986).

12 Austin v. Michigan Chamber of Commerce, 494 U.S. 652, 662 (1990).

13 *Id.* at 659.

14 128 S.Ct. 2759 (2008)

15 528 U.S. 377, 391.

16 548 U.S. at 253.

17 *See Davis,* 128 S.Ct. at 2774-2775 (citing *Buckley*, 424 U.S. at 64).

18 Shrink Missouri, 528 U.S. at 393 ("whatever the State's evidentiary obligation may be" satisfied).

19 548 U.S. at 261.

20 *Id.* at 253-54.

21 551 U.S. 449, 127 S.Ct. 2652, 2664 (2007); *see also Austin*, 494 U.S. at 655 (upholding statute as "narrowly tailored to serve a compelling state interest," without using phrase "strict scrutiny").

22 128 S.Ct. 2759, 2772 (citing Day v. Holohan, 34 F.3d 1356, 1359-1360 (8th Cir. 1994)).

23 *Id.* at 2773-74.

24 *See, e.g.*, Adam Liptak, *Court Appears Poised to Rewrite Spending Rules*, N.Y. Times, June 29, 2009, http://www.nytimes.com/2009/06/30/us/politics/30movie.html?_r=2.

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31 S. 1285, 100th Congress.

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Intellectual Property

The Constitutional Challenge to Statutory Damages for Copyright Infringment: Don't *Gore* Section 504

*By Steven M. Tepp**

In its 1996 decision in *BMW v. Gore*, the Supreme Court read the Due Process Clause of the Fourteenth Amendment to impose limitations on the discretion of juries to impose punitive damages.[1] Recently, some defendants in copyright infringement cases have argued that the standard set forth in *Gore* should be applied at least to limit the Copyright Act's provision of statutory damages for civil infringement on the grounds that such damages are unconstitutionally excessive, punitive damages.[2] Although no court has ever accepted this argument, there is a relative paucity of decisions on the subject, leaving the ultimate direction of the law in some doubt. This article seeks to begin to fill the void by providing a comprehensive review of the question. Part I will recount the history of statutory damages in copyright, demonstrating that they are a long-standing aspect of U.S. law and the product of over two centuries of collective wisdom. Part II will summarize the three-part test the Court crafted in *Gore* and note the policy considerations that drove the Court's rationale in that case and its progeny. Part III will analyze whether to apply and what result accrues from the application of that three-part test to statutory damages for copyright infringement. This article concludes that copyright statutory damages are different from the punitive damages at issue in *Gore*, do not raise the policy concerns that were present in *Gore*, that the three-part test does not apply, and that even if that test were applied, the provisions of the Copyright Act would pass muster.

I. History of Statutory Damages for Copyright Infringement

Statutory damages for civil copyright infringement (hereinafter "statutory damages") are among the most venerable aspects of American copyright law. Prior to the ratification of the Constitution, several state copyright statutes provided for either a statutory maximum and minimum award (Massachusetts, New Hampshire, and Rhode Island) or a fixed sum to be paid for each infringing copy (Maryland and South Carolina).[3]

After the ratification of the Constitution, Congress wasted little time in enacting federal copyright protection. The Copyright Act of 1790 included a provision for statutory damages; it was "fifty cents for every [infringing] sheet... one [half] thereof to and for the use of the United States."[4] It is noteworthy that from the very first instance of federal copyright protection, statutory damages have served a hybrid purpose beyond merely compensating the aggrieved copyright owner.

Through much of the nineteenth century statutory damages were increased and expanded to apply to the infringement of newly protected categories of works.[5] However, in the Copyright Act of 1895, Congress for the first time departed from the traditional manner of calculation of statutory damages (per infringing copy/performance) to the standard we are familiar with today (per infringed work).[6] While maintaining the traditional method for some categories of works, the Act provided:

> In the case of infringement of a copyrighted photograph made from any object not a work of fine arts, the sum recovered was to be not less than $100 nor more than $5,000, and that in the case of infringement of a copyright in a painting, drawing, engraving, etching, print, or model or design for a work of art, or a photograph of a work of the fine arts, the sum to be recovered was to be not less than $250 nor more than $10,000. One half of such sum accrued to the copyright proprietor and the other half to the United States.[7]

The Copyright Act of 1909 generally carried forward the statutory damages provisions of the 1895 Act, but two aspects of that enactment are noteworthy. First, in what appears to be an historically unique instance, Congress reduced the maximum level of statutory damages to $5,000. This appears to have been in direct response to the testimony of a prominent attorney who believed that an adverse judgment in a prior infringement action was a direct result of the judge's unwillingness to impose the level of statutory damages that the law would have compelled had infringement been found, but which "were altogether incommensurate with any suffering which [the plaintiff] had endured or with any profit which our opponent had derived from the practice."[8]

Second, in setting the levels of statutory damages, it is evident that Congress made an effort to approximate realistic levels of actual damages. The legislative history contains examples of this with regard to musical works reproduced in the form of player piano rolls[9] and newspaper reproduction of photographs.[10] Thus, historically, Congress has specifically acted to set statutory damages at levels that were compensatory and not likely to produce manifestly unjust or extravagant awards.

The Copyright Act of 1976[11] put in place the statutory damages structure that remains the law today.[12] Those amendments did away entirely with the "per infringing copy" standards in favor of a single "per infringed work" framework applicable to all copyrightable works: $250 to $10,000. In order to address concerns about the unjust application of statutory minimums to "innocent" infringers, a sub-minimum of $100 was established.[13] Conversely, a ceiling of $50,000 was established for instances where the plaintiff demonstrates that the infringement was willful.[14]

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The extensive legislative history of the 1976 Act provides useful insight into how and why statutory damages are structured the way that they are. In a report to Congress, the Register of Copyrights reviewed the principles undergirding statutory damages:

> The need for this special remedy arises from the acknowledged inadequacy of actual damages and profits:
>
> • The value of a copyright is, by its nature, difficult to establish, and the loss caused by an infringement is equally hard to determine. As a result, actual damages are often conjectural, and may be impossible or prohibitively expensive to prove.
>
> • In many cases, especially those involving public performances, the only direct loss that could be proven is the amount of a license fee. An award of such an amount would be an invitation to infringe with no risk of loss to the infringer.
>
> • The actual damages capable of proof are often less than the cost to the copyright owner of detecting and investigating infringements.
>
> • An award of the infringer's profits would often be equally inadequate. There may have been little or no profit, or it may be impossible to compute the amount of profits attributable to the infringement. Frequently, the infringer's profits will not be an adequate measure of the injury caused to the copyright owner.
>
> In sum, statutory damages are intended (1) to assure adequate compensation to the copyright owner for his injury and (2) to deter infringement.[15]

In considering the appropriate maximum and minimum amounts of statutory damages, great attention was paid to both the adequacy of the compensation and deterrent effect as well as to the desire to avoid exorbitant awards, especially in instances of multiple infringements.[16] The question of multiple infringements was addressed in several ways, including the minimum level of ordinary statutory damages and the still lower level available in the case of innocent infringers.[17] In the end, Congress was satisfied that these safeguards allowed the statutory damages system to serve its purpose without imposing undue levels of liability.[18]

The dollar amounts for statutory damages were all doubled by the Berne Convention Implementation Act of 1988.[19] Those amounts were later raised by fifty percent (except the innocent infringer level, which remained at $200) by the Digital Theft Deterrence and Copyright Damages Improvement Act of 1999,[20] bringing us to the current range of $750 to $30,000, or up to $150,000 where the infringement was willful.[21] The legislative history of the latter clearly states Congress' concerns that digital technology and the Internet had resulted in substantial economic costs to copyright owners and the U.S. economy as a whole.[22] Congress saw a need to increase the level of statutory damages because:

> [m]any computer users... simply believe that they will not be caught... [a]lso, many infringers do not consider the current copyright infringement penalties a real threat and continue infringing, even after a copyright owner puts them on notice.... In light of this... H.R. 1761 increases copyright penalties to have a significant deterrent effect on copyright infringement.[23]

This demonstrates Congress' view that statutory damages must both provide compensation and result in deterrence; Congress did not describe statutory damages as punitive.

II. Due Process and Punitive Damages

A. BMW v. Gore[24]

Outside the copyright context, in 1996, the Supreme Court struck down an award of $2 million in punitive damages on top of a $4,000 award in compensatory damages by an Alabama state court to Mr. Ira Gore, Jr., the purchaser of a used BMW automobile to whom the dealer did not disclose that the vehicle had been repainted since its initial manufacture.[25] The basis of the Court's decision was that the award was "grossly excessive" and therefore violated the Due Process Clause of the Fourteenth Amendment.[26] The Court set forth three "guideposts" for evaluating whether punitive damages are grossly excessive: the degree of reprehensibility of the defendant's conduct, the disparity between the harm or potential harm suffered by the plaintiff and the punitive damages award, and the difference between this remedy and the penalties authorized in comparable situations.[27]

The first guidepost is the degree of reprehensibility of the defendant's conduct. The Court described the degree of reprehensibility guideline as "[p]erhaps the most important indicium of the reasonableness of a punitive damages award."[28] Specifically mentioned as reprehensible were "crimes marked by violence," "trickery and deceit," and "intentional malice."[29] The Court also noted that "infliction of economic injury, especially when done intentionally through affirmative acts of misconduct... can warrant a substantial penalty."[30] Further, the Court held that "evidence that a defendant has repeatedly engaged in prohibited conduct while knowing or suspecting that it was unlawful would provide relevant support for an argument that strong medicine is required to cure the defendant's disrespect for the law."[31]

The second guidepost rejects outright any notion that punitive damages could be subjective, demanding instead that "exemplary damages must bear a 'reasonable relationship' to compensatory damages."[32] It is perhaps telling that in citing examples of existing federal law which provide punitive damages, the Court cited the treble damages provisions of trademark law and patent law, but not the statutory damages provisions of the Copyright Act.[33]

In assessing a reasonable ratio, the Court "rejected the notion that the constitutional line is marked by a simple mathematical formula.... We can say, however, that a general concer[n] for reasonableness... properly enter[s] into the constitutional calculus."[34] Expanding on this, the Court observed that "[a] higher ratio may also be justified in cases in which the injury is hard to detect or the monetary value of noneconomic harm might have been difficult to determine."[35] Nonetheless, the Court did appear to put an outer boundary on the ratio at 10-1.[36]

The third guidepost is the sanctions for comparable misconduct. This provides for a comparison of the punitive damages to both civil and criminal penalties that are available.[37] In conducting this comparison, the Court instructed that "a reviewing court engaged in determining whether an award

of punitive damages is excessive should 'accord "substantial deference" to legislative judgments concerning appropriate sanctions for the conduct at issue.'"[38] While it clearly referenced criminal penalties, the Court gave no guidance on how to place a value on imprisonment.

B. Subsequent Case Law

Since *Gore*, the Supreme Court has issued two more rulings that have provided a bit more context and detail for the application of the guideposts. In *State Farm v. Campbell* the Court reversed a punitive damages award by a Utah state court of $145 million on top of an award of $1 million in compensatory damages to Ms. Inez Campbell and the estate of her late husband for State Farm's bad faith, fraud, and intentional infliction of emotional distress.[39] The Court reiterated the underpinning of its application of the Due Process Clause to punitive damages, noting that "elementary notions of fairness enshrined in our constitutional jurisprudence dictate that a person receive fair notice not only of the conduct that will subject him to punishment, but also of the severity of the penalty...."[40]

In early 2007 the Court reversed an award of $79.5 million in punitive damages on top of an award of $821,000 in compensatory damages to the estate of a smoker in *Philip Morris USA v. Williams*.[41] In its decision, the Court noted that it "has long made clear that 'punitive damages may properly be imposed to further a State's legitimate interests in punishing unlawful conduct and deterring its repetition.'"[42] Importantly, the Court also held that, "[u]nless a State insists upon proper standards that will cabin the jury's discretionary authority, its punitive damages system may deprive a defendant of 'fair notice,' ... it may threaten 'arbitrary punishments' ... that reflect not an 'application of law' but 'a decisonmaker's caprice.'"[43] Taken together, *State Farm* and *Philip Morris* indicate that the Court's due process concerns were both procedural (notice) and substantive (not capricious).[44]

III. Can and Should the Gore "Guideposts" Be Applied to Statutory Damages?

While the *Gore* guideposts apply to punitive damage awards, there is no indication from the Court that they should or do apply to statutory damages. A threshold question to address is whether statutory damages are punitive. As noted above, there are different levels of statutory damages available for innocent infringements, ordinary infringements, and willful infringements. For purposes of this analysis, this article considers that there are two levels, or types, of statutory damages: compensatory and enhanced. The innocent infringer reduction is a sub-class of the first, or compensatory type.[45]

A. Are Compensatory Statutory Damages Punitive?

It appears elementary that compensatory damages are not punitive and thus not subject to the guideposts. However, two instances have been presented where statutory damages are argued to be punitive in effect. The first is where even the minimum statutory damages award is grossly excessive in comparison to actual damages. The second is where multiple infringements generate a huge total statutory damages award.

The first instance is claimed by some to exist in the context of lawsuits for infringement arising from the use of file-sharing software. In this instance, some have suggested that the actual damages to the plaintiffs are a mere seventy cents, a common royalty rate paid to the copyright owner of a sound recording for the licensed download of that sound recording.[46] Compared to the statutory minimum of $750, this is a remarkable discrepancy. Yet this valuation ignores the degree to which the infringement facilitates and promotes other infringements of the work and the extent to which it contributes to the popularity of peer-to-peer infringements.[47] The flaw in this narrow view of compensation was described nearly a half a century ago by the Register of Copyrights, who noted that an award of mere licensing fees "would be an invitation to infringe with no risk of loss to the infringer."[48]

Beyond the example of peer-to-peer infringement, this raises the question of whether the $750 minimum is so high that it is likely to produce awards beyond actual damages. Indeed, common consumer products like CDs, DVDs, books, and videogames all cost substantially less than $750. Of course, the statutory damages framework is applied on a per infringement basis, so a thousand infringing copies of a single work is subject to the same $750 minimum statutory damages award as a single infringing copy.

This leaves the instance involving a single or very few infringements of a single work. The infringer would be subject to a minimum of $750 in statutory damages. Of course, that award would come about only as a result of federal litigation. One might reasonably conclude that litigation in such an instance is highly unlikely given the time and expense of the undertaking relative to the damage done and likely award. Granted, a successful plaintiff might be able to obtain an award that includes attorney's fees,[49] but there is no guarantee that will be the case. It simply does not make sense to risk tens of thousands of dollars in litigation expenses over a $750 award. Even if one might imagine a sufficiently headstrong plaintiff, willing to bring such a case and completely uninterested in settlement, the entire scheme of statutory damages ought not rise or fall over such a far-fetched and unlikely scenario.

As discussed earlier, Congress has historically made an effort to adjust statutory damages to properly compensatory levels.[50] Presumably, the $750 minimum represents Congress' judgment as to the lowest reasonable estimation of the true actual damages. It is worth noting that, adjusted for inflation, statutory damages are considerably lower today than they were in 1909. For example, the $250 minimum in the 1909 Act equates to well over $5,000 today.[51]

The second instance in which some have suggested that statutory damages are punitive is multiple infringements generating a huge statutory damages award.[52] While the argument may have use as a polemic tool, it fails to advance the legal analysis. Indeed, the infringement of a huge number of works *should* result in a huge award of damages, lest it fail to compensate the copyright owner and/or allow the infringer to retain some amount of profit from its illegal activity. Moreover, as discussed above, Congress has given the issue of multiple infringements specific attention and the law reflects its judgment as to how best to achieve compensation.[53]

B. Are Enhanced Statutory Damages Punitive?

Where a court has found the defendant's infringement willful and awarded an enhanced level of statutory damages, there is a better argument that the award is punitive. In describing the purpose of statutory damages, Congress has referred to compensation and deterrence.[54] Deterrence is not necessarily synonymous with punishment, even though they both may be achieved through the same means: monetary awards in excess of mere compensation. The distinction thus appears to exist in the policy goal that drove the enactment of statutory damages, not the means through which that goal is achieved.

The Supreme Court has stated that deterrence is one of the objectives of punitive damages.[55] Yet the opposite is not necessarily true; while statutory damages clearly are designed to be deterrent, that objective is not paired with punishment or retribution.[56] Perhaps this explains the apparent distinction the Supreme Court perceives between treble damages and statutory damages.[57]

The aim of providing civil remedies for copyright infringement that are deterrent but not punitive is consistent with the global standards for copyright protection found in the World Trade Organization:

> The judicial authorities shall have the authority to order the infringer to pay the right holder damages adequate to compensate for the injury the right holder has suffered....[58]

> Members shall ensure... remedies which constitute a deterrent to further infringements.[59]

Similarly, numerous Free Trade Agreements which the United States has ratified obligate the signatories to provide statutory damages "in an amount sufficiently high to constitute a deterrent to future infringements and with the intent to compensate the right holder...."[60]

By its terms, the guideposts employed by the Court in the *Gore* line of cases apply to punitive damages. While statutory damages may have one aspect in common with punitive damages (deterrence), that does not transform them into punitive damages.[61]

The Sixth Circuit recently recognized this distinction in *Zomba Enterprises, Inc. v. Panorama Records, Inc*.62 In that case, defendant Panorama was found to have willfully infringed plaintiff Zomba's copyright in certain musical works. Enhanced statutory damages of $31,000 for the infringement of each of 26 works were awarded, totaling $806,000.63 Panorama challenged the constitutionality of the award on due process grounds. The court noted the distinction between the Supreme Court's rulings regarding punitive damages in *Gore* and *State Farm* and the question of statutory damages at bar.64 Finding "no case invalidating such an award of statutory damages under *Gore* or *Campbell* [*State Farm*] ..." the court declined to apply the guidelines. Instead, the court applied the standard set forth by the Supreme Court in *St. Louis*, *I.M. & S. Ry. Co. v. Williams,* that the statutory award is to be invalidated "only where the penalty prescribed is so severe and oppressive as to be wholly disproportionate to the offense and obviously unreasonable."[65]

It appears that Congress' stated intent in enacting was deterrent but not punitive. This distinction carries over into international characterizations of statutory damages. Furthermore, the Supreme Court has chosen to apply a completely different standard in recent punitive damages cases than it has historically in the statutory damages context. Thus, there is good reason to view statutory damages as deterrent, but not punitive. As such, the *Gore* line of cases does not apply and should not be applied. If any due process standard must be applied in the review of statutory damages, it is the one the Supreme Court has itself applied in the *Williams* decision.

C. Do Statutory Damages Implicate the Policy Considerations Present in the Gore Line of Cases?

Even if statutory damages could be construed as punitive, one might fairly question whether the concerns the Court had with the punitive damage awards in *Gore*, *State Farm*, and *Philip Morris* would be present in the context of a statutory damages award. As noted above, the due process concerns that have moved the Court are fair notice of the offense and the severity of the penalty.[66] In contrast to unregulated punitive damages awards (such as those at issue in *Gore* and its progeny), the scope of copyright protection and the provision of statutory damages for infringement are clearly codified in federal law and have been so for over two centuries. No serious contention can be made that there is a lack of notice in either respect. "The unregulated and arbitrary use of judicial power" that the *Gore* guideposts remedy is not implicated in Congress' carefully crafted and reasonably constrained statute.[67]

To the extent that a defendant may argue that the range of damages available is "grossly excessive," it is noteworthy that Congress has throughout the history of the Copyright Act sought to calibrate statutory damages at a reasonable level based on objective market prices and expert testimony.[68] It is a tall order to contend to a court that despite the peaceful coexistence of the Due Process Clause and statutory damages for over two centuries, the latter is inconsistent with the former. Indeed, the Supreme Court has already had several opportunities to consider the constitutionality of aspects of the Copyright Act that, like statutory damages, trace their origin back to 1790. The most recent was *Eldred v. Ashcroft* in 2003:

> The [appeals] court recounted that "the First Congress made the Copyright Act of 1790 applicable to subsisting copyrights arising under the copyright laws of the several states." [*Eldred v. Reno,* 239 F.3d 372 (D.C. Cir. 2001).] That construction of Congress' authority under the Copyright Clause "by [those] contemporary with [the Constitution's] formation," the court said, merited "very great" and in this case "almost conclusive" weight. *Ibid.* (quoting *Burrow-Giles Lithographic Co. v. Sarony, 111 U.S. 53, 57, 28 L. Ed. 349, 4 S. Ct. 279, 1884 Dec. Comm'r Pat. 186 (1884)*). As early as *McClurg v. Kingsland, 1 How. 202, 42 U.S. 202, 11 L. Ed. 102 (1843)*, the Court of Appeals added, this Court had made it "plain" that the same Clause permits Congress to "amplify the terms of an existing patent." *239 F.3d at 380*. The appeals court recognized that this Court has been similarly deferential to the judgment of Congress in the realm of copyright. *Ibid.* (citing *Sony Corp. of America v. Universal City Studios, Inc., 464 U.S. 417, 78 L. Ed. 2d 574, 104 S. Ct. 774 (1984)*; *Stewart v. Abend, 495 U.S. 207, 109 L. Ed. 2d 184, 110 S. Ct. 1750 (1990)*).[69]

The Court in *Gore* agreed that "a reviewing court engaged in determining whether an award of punitive damages is excessive should 'accord substantial deference' to legislative judgments concerning appropriate sanctions for the conduct at issue."[70] There is nothing in the *Gore* decision to suggest that the Court wished to or saw itself as substituting its own judgment for that of the legislature as to appropriate limits on a jury's discretion to award damages. Rather, the Court was applying its judgment in the *absence* of the legislature's judgment or any other limit on the jury's discretion. The case in statutory damages could not be more different. In fact, the Court has already found itself comfortable with Congress' selection of a range for statutory damages in an earlier version of the Copyright Act.[71] It bears noting again that the statutory range of $250 minimum and $5,000 maximum approved by the Court in *Woolworth* in 1952, when adjusted for inflation, equates to a range of roughly $2,000 minimum and $40,000 maximum in 2007 dollars.[72] Both of these figures exceed the actual present statutory amounts for ordinary infringements.

Finally, a defendant may argue that statutory damages as applied by a particular jury represent a grossly excessive punitive award. Historically, the Court has given great latitude to awards of statutory damages.[73] Further, this argument runs headlong into the Court's post-*Gore* deference for jury decisions in copyright; "in cases where the amount of the damages was uncertain[,] their assessment was a matter so peculiarly within the province of the jury that the Court should not alter it."[74] In invoking this language with regard to statutory damages two years after its decision in *Gore*, the Court has already at least implied its view that statutory damages are not subject to the guideposts.

D. What Is the Result of an Application of the Guideposts to Statutory Damages?

Notwithstanding the above analysis, one might wonder what result would be generated by applying the guideposts to statutory damages.

1. Degree of Reprehensibility

To the extent that statutory damages are in fact subjected to the guideposts, it seems more likely to occur in the context of enhanced statutory damages. As such, the reprehensibility of the act prong overlaps with the willful standard for the award of an enhanced level of statutory damages.[75] The Court in *Gore* held that conduct is reprehensible and justifies a penalty when it is intentional.[76] It also held that an increased award is appropriate where the conduct was repeated and at least suspected by the defendant to be a violation.[77] Given the widespread publicity surrounding copyright infringement on peer-to-peer systems and the recording industry's concomitant litigation, where the defendant has distributed numerous copyrighted works on a peer-to-peer system, it would tax credulity to argue that this standard has not been met.

The Court has also held that "[e]vidence of actual harm to nonparties can help to show that the conduct that harmed the plaintiff also posed a substantial risk of harm to the general public, and so was particularly reprehensible." [78] Again, where the defendant is part of the machinery of the distribution of billions of copyrighted works on a peer-to-peer system, that defendant is not only harming the specific copyright owners, but is undermining the incentives in the Copyright Act to create new works for the benefit of the public. For all these reasons, an enhanced award is supported.

2. Ratio of Punitive Damages to Actual Harm

Application of this guidepost is problematic, at best. Indeed, the ratio of the harm suffered by the plaintiff to "punitive" damages borders on the farcical where the statute is specifically designed to relieve the plaintiff of having to prove actual harm. It is an analysis that is precluded by the very nature of statutory damages.

It is worth noting, nevertheless, that the current statutory framework appears calibrated to a 4:1 ratio. That is, statutory damages for routine infringements may receive an award of up to $30,000. In the case of willful infringements, the court may raise that amount another $120,000, for a total of $150,000. That represents a 4:1 ratio, well under the Court's 10:1 threshold.

3. Sanctions for Comparable Misconduct

Similarly, the difference between a given award and remedies available in similar cases is a pointless inquiry here. By definition, an award of statutory damages must be within the congressionally authorized range. It is a tautology to inquire whether an award within the range of statutory damages is consistent with legislative judgments concerning the appropriate sanction for the conduct at issue.

The Court will also consider the availability of criminal penalties as a sign of the seriousness of the government's interest in the offense and judgment concerning appropriate sanctions.[79] Criminal penalties are available for copyright infringement[80] and carry a penalty of up to five years in prison and a fine of up to $250,000 for a first offense involving the infringement of works that have a total value of more than $2,500.[81] Considering only the fine, Congress has specifically enacted a penalty that can be as much as 100 times the actual damages caused by the first offense. Subsequent offenses are subject to up to 10 years in prison and a fine of up to $500,000 (a ratio of up to 200:1).[82] All of these facts support an award of enhanced statutory damages.

Thus, it appears that application of the guideposts is awkward at best and, in any case, appears to favor upholding statutory damages award.

CONCLUSION

Statutory damages are a time-honored and accepted method for assessing awards in copyright infringement litigation. Recent decisions regarding the Due Process Clause and punitive damages are not applicable to statutory damages and should not be shoehorned into this field. The courts should continue to defer to Congress' historically careful judgment in this area.[83]

Endnotes

1 517 U.S. 559 (1996).

2 *See* Defendant Bertlesmann A.G., Bertlesmann, Inc., and Bemusic, Inc.'s Notice of Motion and Conditional Motion for Summary Judgment, *In re Napster, Inc. Copyright Litigation*, No. C-MDL-00-1369 MHP (N.D. Calif. July 21, 2006); Defendant James Michael Boggs' Response in Opposition to Plaintiff's Rule 12(b)(6) Motion to Dismiss Counterclaims, *Atlantic Recording Corp. v. Boggs*, C.A. No. 2:06-cv-00482 at 22 (S.D. Tex. April 26, 2007); Answer, Affirmative Defenses and Counterclaims, *Lava Records LLC, et al. v. Amurao*, No. 07 CV 321 (CLB)(S.D.N.Y. Feb. 12, 2007).

3 William S. Strauss, U.S. Copyright Office, *Studies on Copyright Law Revision Prepared for the Sen. Subcomm. on Patents, Trademarks, and Copyrights: The Damage Provisions of the Copyright Law (Study No. 22)* 1 (1956).

4 1 Stat. 124-26 (1790).

5 *See* Copyright Act of 1802 (2 Stat. 171 (1802) (making designs, engravings, and prints eligible for copyright protection and providing for statutory damages of $1 for every infringing print)); Copyright Act of 1831 (4 Stat. 436 (1831) (making musical works eligible for copyright protection and providing for statutory damages of $1 for every infringing sheet)); Copyright Act of 1856 (11 Stat. 138 (1856) (granting performance and publication rights in dramatic compositions and providing for statutory damages of not less than $100 for the first unauthorized performance and $50 for every subsequent unauthorized performance)); Copyright Act of 1870 (16 Stat. 198) (setting statutory damages for the infringement of paintings and statues at $10 for each infringing copy)).

6 28 Stat. 956 (1895).

7 Strauss, *supra* note 3 at 2.

8 Arguments Before the Comms. on Patents of the Senate and House Conjointly, on S. 6330 and H.R. 19853 to Amend and Consolidate the Acts Respecting Copyright, 59th Cong., 142 (Dec. 7-8, 10-11, 1906) (statement of Ansley Wilcox, Esq., of Buffalo, N.Y.). *See* H.R. Rep. No. 60-2222, at 15 (1909).

9 *See* Arguments Before the Comms. on Patents of the Senate and House, Conjointly, on S. 6330 and H.R. 19853 to Amend and Consolidate the Acts Respecting Copyright, 59th Cong., 123-24, 199 (June 6-9, 1906) (statement of Charles S. Burton, Esq. of Chicago, Ill.).

10 *See* Hearings Before the Comms. on Patents of the Senate and House on Pending Bills to Amend and Consolidate the Acts Respecting Copyright, 60th Cong., 150-60 (Mar. 26-28, 1908); H.R. Rep. No. 60-2222, at 15 (1909).

11 90 Stat. 2541 (1976).

12 *See* 17 U.S.C. § 504(c).

13 S. Rep. 94-473, at 162-63 (1975). Innocent infringers are those who "sustain[] the burden of proving... that [they] were not aware and had no reason to believe that his or her acts constituted an infringement...." 17 U.S.C. § 504(c)(2).

14 *Id.*

15 Register of Copyrights, 87th Cong., *Report on the General Revision of U.S. Copyright Law* 102-03 (Comm. Print 1961).

16 *Id.* at 104-05.

17 Register of Copyrights, 89th Cong., *Supplemental Report on the General Revision of U.S. Copyright Law* 135-37 (Comm. Print 1965).

18 S. Rep. 94-473, at 143-45 (1975); H.R. Rep. 94-1476, at 161-63 (1975).

19 102 Stat. 2853, 2860 (1988).

20 113 Stat. 1774 (1999).

21 17 U.S.C. § 504(c) (2007).

22 H.R. Rep. 106-216, at 3 (1999).

23 *Id.*

24 517 U.S. 559 (1996).

25 *Id.*

26 *Id.* at 568, 574.

27 *Id.* at 574.

28 *Id.* at 575.

29 *Id.* at 576.

30 *Id.*

31 *Id.* at 576-77 (citation omitted).

32 *Id.* at 580 (citations omitted).

33 *Id.* at 581, n.33 (citing 15 U.S.C. § 1117; 35 U.S.C. § 284).

34 *Id.* at 582-83 (citation omitted).

35 *Id.* at 582.

36 *Id.*

37 *Id.* at 583.

38 *Id.* (citation omitted).

39 538 U.S. 408 (2003).

40 *Id.* at 417 (citing *Gore,* 517 U.S. at 574).

41 166 L. Ed. 2d 940 (2007).

42 *Id.* at 948 (citing *Gore,* 517 U.S. at 568).

43 *Id.* (citations omitted).

44 Blaine Evanson, *Due Process in Statutory Damages*, 3 Geo. J.L. & Pub. Pol'y 601, 603 (2005).

45 Although the reduced award for innocent infringers may not be fully compensatory to the aggrieved copyright owner, it falls within the compensatory class as it by definition does not involve a finding of willfulness and does not include a correspondingly enhanced award. In essence, the compensatory class is defi ned here as every statutory damages award that is not enhanced.

46 J. Cam Barker, *Grossly Excessive Penalties in the Battle Against Illegal File-Sharing: The Troubling Effects of Aggregating Minimum Statutory Damages for Copyright Infringement*, 83 Tex. L. Rev. 525 (2004); Defendant James Michael Boggs' Response in Opposition to Plaintiff's Rule 12(b)(6) Motion to Dismiss Counterclaims, Atlantic Recording Corp. v. Boggs, C.A. No. 2:06-cv-00482 at 22 (S.D. Tex., April 26, 2007).

47 *See* MGM v. Grokster, 545 U.S. 913, 924-26 (2005).

48 *See supra* note 16.

49 *See* 17 U.S.C. § 505.

50 *See supra* notes 9-11.

51 The inflation calculator provided on the website of the Bureau of Labor Statistics (www.bls.gov) shows that $250 in 1913 (the earliest date available) is worth $5,250.43 today.

52 *See* Barker, *supra* note 46, at 537; Defendant Bertlesmann A.G., Bertlesmann, Inc., and Bemusic, Inc.'s Notice of Motion and Conditional Motion for Summary Judgment, In re Napster, Inc. Copyright Litigation, No. C-MDL-00-1369 MHP (N.D. Calif. July 21, 2006).

53 *See supra* notes 17-19.

54 *See supra* note 24.

55 *State Farm* at 416 ("punitive damages serve a broader function; they are aimed at deterrence and retribution.") (citations omitted).

56 *See supra,* note 24; *but see* On Davis v. The Gap, Inc., 246 F.3d 152, 172 (2d. Cir. 2001)("The purpose of punitive damages—to punish and prevent malicious conduct—is generally achieved under the Copyright Act through the provisions of 17 U.S.C. § 504(c)(2)....").

57 *See supra* note 34.

58 Agreement on Trade-Related Aspects of Intellectual Property Rights (1994), Article 45. Article 45 also permits the adoption of "pre-established" damages.

59 *Id*. at Article 41.

60 *See* Singapore-U.S. FTA, Art. 16.9.9; Morocco-U.S. FTA, Art. 15.11.7; Central America-U.S. FTA, Art. 15.11.8. It is worth noting that in light of these provisions, a ruling that statutory damages generally are unconstitutional, or even that only enhanced statutory damages are unconstitutional, would create serious doubts about whether the United States is meeting its international obligations. Failure to meet those obligations could subject the United States to trade sanctions under the enforcement provisions the Free Trade Agreements.

61 *But see* In re Napster, Inc. Copyright Litigation, No. C MDL-00-1369 MHP (N.D. Calif. June 1, 2005)("Extending the reasoning of Gore and its progeny, a number of courts have recognized that an award of statutory damages may violate due process....") (citing Parker v. Time Warner Entm't Co., 331 F.3d 13, 22 (2d. Cir. 2003); In re Trans Union Corp. Privacy Litig., 211 F.R.D. 328, 250-51 (N.D.Ill. 2002). Both *Parker* and *Trans Union* are distinguishable in that they involve certification of a class action suit, not the application of the *Gore* guideposts.

62 491 F.3d 574 (6th Cir. 2007).

63 *Id*. at 580.

64 *Id*. at 586-87.

65 *Id* at 587 (quoting St. Louis, I.M. & S. Ry. Co. v. Williams, 251 U.S. 63, 66-67 (1919)).

66 *See supra* note 41.

67 Lowry's Reports, Inc. v. Legg Mason, Inc., 302 F. Supp. 2d 455, 460 (D. Md. 2004) (holding that the *Gore* guideposts do not apply to statutory damages) (citing Pacific Mut. Life Ins. Co. v. Haslip, 499 U.S. 1, 20 (1991) ("As long as the discretion is exercised within reasonable limits, due process is satisfied")).

68 *See infra* Part I.

69 Eldred v. Reno, 239 F.3d 372, 379-80 (D.C. Cir. 2001).

70 *Gore,* 517 U.S. at 583 (citations omitted).

71 "The necessary flexibility to do justice in the variety of situations which copyright cases present can be achieved only by the exercise of the wide judicial discretion within limited amounts conferred by this statute." Woolworth Co. v. Contemporary Arts, Inc., 344 U.S. 228, 232 (1952).

72 www.bls.gov.

73 "Even for uninjurious and unprofi table invasions of copyright the court may, if it deems just, impose a liability within statutory limits to sanction and vindicate the statutory policy." 344 U.S. at 233.

74 Feltner v. Columbia Pictures, Inc., 523 U.S. 340, 353 (1998) (citations omitted).

75 "Here... 'willfully' means with knowledge that the defendant's conduct constitutes copyright infringement." 4 Nimmer & Nimmer 14.04[B][3].

76 *See supra* note 31.

77 *See supra* note 32.

78 *Philip Morris,* 549 U.S. at 949.

79 *See supra* note 38.

80 17 U.S.C. § 506.

81 18 U.S.C. § 2319(b).

82 *Id*.

83 Congress continues to reassess the appropriate application of statutory damages. Shortly before this issue went to print, H.R. 4279 was introduced. Section 104 of that bill would amend the statute to allow "either one or multiple awards of statutory damages with respect to infringement of a compilation."

Letter to the Editor: E. Alan Uebler

David L. Applegate concludes in "*In re Bilski*: Business Method Patents Transformed?" (*Engage* 10, no. 1):

> Abstract ideas, mental processes, fundamental truths, and general knowledge remain unpatentable. Inventions or discoveries that are new, nonobvious, useful, and meet the remaining statutory requirements are patentable so long as they are tied to a machine or result in a *physical* transformation of matter.
>
> . . .
>
> The *Bilski* majority has given us a test, [that is]... to be potentially patentable under 35 U.S.C. § 101, a "process" must involve either a "machine" or a "transformation" from one *physical* state to another. (Emphases added)

However, while Supreme Court and Federal Circuit jurisprudence require that patent claims directed to a "process" be tied to a "machine" or involve "transformation of an article to a different state or thing" in order to qualify as patentable subject matter under § 101, there is no requirement that such a transformation be "physical." The assertion that a "physical transformation of matter" must be present overly restricts the Supreme Court mandate and adds to the already abundant confusion in the wake of *In re Bilski et al*.[1]

In *Gottshalk v. Benson*,[2] the Supreme Court set the standard by saying:

> Transformation and reduction of an article "to a different state or thing" is the clue to the patentability of a process claim that does not include particular machines.[3]

after quoting with approval the earlier case of *Cochrane v. Deener*,[4] wherein the Court had said:

> A process is a mode of treatment of certain materials to produce a given result. It is an act, or a series of acts, performed upon the subject-matter to be transformed and reduced to a different state or thing.[5]

Benson involved an algorithm, not tied to a particular machine. In essence, the *Benson* patentees claimed the algorithm, an abstract intellectual concept which was wholly preempted by the claim and therefore held to be not proper subject matter under § 101.

Creating confusion by asserting open-ended multiple negatives, the *Benson* Court went on to say:

> It is argued that a process patent must either be tied to a particular machine or apparatus or must operate to change articles or materials to a "different state or thing." We do not hold that no process patent could ever qualify if it did not meet the requirements of our prior precedents. It is said that the decision precludes a patent for any program servicing a computer. We do not so hold.[6]

Under the *Benson* rule, two, and only two, possible scenarios arise. All "process" claims, to satisfy § 101, must be divided into either (a) a claim which *does* include a particular machine, that is, where a particular machine is expressly set out, and which *does* present statutory subject matter without any doubt; or (b) a claim which *does not* include a particular machine, which necessitates further inquiry. Following the rule of *Benson,* there are no other possibilities which will satisfy the Court's precedents.

When no particular machine is involved, for a process claim to be patentable, a "transformation and reduction" of an "article" to a "different state or thing" is required, at the very least. Additional unanswered questions arise: What comprises an "article"? What constitutes "reduction"? What constitutes a "transformation" which will suffice?

As an aside, § 101 requires only that the process be "new and useful." It does not define what is "new." That is left to § 102, which provides a well-defined, unequivocal definition.

What is "useful" as required by § 101? Is it simply the extraction in the thermodynamic sense of useful work as in, for example, a perpetual motion machine, which would thereby be excluded from § 101 for failing such a test, this in addition to "phenomena of nature," "abstract concepts," and "natural laws"? Such a definition of "useful" would appear to satisfy all criteria when coupled with the added alternative "machine" requirement of *Benson*.

In 1981, nine years after *Benson*, the Supreme Court decided *Diamond v. Diehr*.[7] The *Diehr* claim was directed to a method of operating "a rubber-molding press" with the aid of a digital computer, more specifically, a process for iteratively controlling and operating a particular *machine*, i.e., a rubber-molding press. Therefore, without serious question, the *Diehr* process claim *is* statutory under the first prong of the *Benson* rule (above), that is, it includes a particular machine. Beyond that, the *Diehr* majority compounded the confusion by gratuitously citing the *Benson* rule, which requires *either* a "machine" or, when no machine is tied in, a "transformation," and saying:

> On the other hand, when a claim containing a mathematical formula implements or applies that formula in a structure or process which, when considered as a whole, is performing a function which the patent laws were designed to protect (*e.g.*, transforming or reducing an article to a different state or thing), then the claim satisfies the requirements of § 101.

This additional "transformation" recitation was not needed to find the *Diehr* "machine" claim statutory under § 101. *Diehr*'s process unquestionably also "transformed" an article (uncured rubber) to "a different state or thing" (cured rubber), *in addition* to being tied to a "machine," thereby satisfying both prongs of the *Benson* requirements.

Justice Stevens and the minority in *Diehr* muddied the waters further when they tried to inject a § 102 issue into the discussion of § 101 statutory subject matter requirements. The minority continued to ignore Judge Rich's spoon-feeding of basic concepts of patent law principles which he had previously set out in *In re Bergy*.[8]

Prior to *Bilski*, then, in view of *Cochrane*, *Benson* and *Diehr*, the threshold question in deciding whether a "process" claim in a patent satisfies § 101 becomes: *Is the claim tied to a particular machine?* If the answer is "yes," the issue is resolved, and the statute is satisfied under the first prong of *Benson* (the "machine" prong). If the answer is "no," if no "machine" is involved, then until the Supreme Court advises us further as to what they "do so hold" (as opposed to their "We do not so hold" admonition of *Benson*) one must look to the second

prong of *Benson* and ask whether an "article" is "transformed and reduced" to "a different state or thing." If it is, then the claim is directed to statutory subject matter and the § 101 requirement is met. If not, the claim is unpatentable.

In none of the currently controlling precedents is there a requirement that the "transformation," when one is required, be a "*physical*" transformation. In the briefing leading to the Federal Circuit's *AT&T* decision,[9] *Excel*'s counsel had argued strenuously that a "physical" transformation was necessary. The Court rejected the argument. In *Bilski* the Court specifically said:

> Thus, the proper inquiry under § 101 is not whether the process claim recites sufficient "physical steps," but rather whether the claim meets the machine-or-transformation test.[10]

Therefore, neither *Bilski* nor any other currently viable precedent requires that a process patent claim involve a machine or a transformation from one "physical" state to another in order to satisfy § 101. A transformation, including all that falls within the scope of that term, is all that the claim drafter must provide.

CONCLUSION

A "process" claim in a patent satisfies the requirements of 35 USC § 101 if *and only if* (a) a "machine" is integral in the process, or, when no machine is involved, (b) the "process" involves "transforming and reducing" an "article" to "a different state or thing." *Benson*, *Diehr*, *Bilski*.

Under (b), is *State Street* still viable? The answer must be "yes." The claim in *State Street Bank & Trust Co. v. Signature Financial Group, Inc*.[11] was directed to a "machine", i.e., "A data processing system... comprising... computer processor means, ... storage means…." The first prong of *Benson* is satisfied and an issue of "transformation" does not need to be addressed. The "useful, concrete and tangible result" language of *State Street* would appear to be subsumed in *all* "machine" claims and appears redundant in *State Street*.

Currently, post-*Bilski*, nothing much appears to have changed. *Benson, Diehr* and *State Street* remain good law. No patents will be granted for scientific truths, abstract ideas or natural phenomena. "Process" claims will be granted when tied to a particular machine or, if not so tied, when the process operates to transform and reduce articles or materials to "a different state or thing," provided the process also satisfies the novelty, nonobviousness and disclosure requirements of the patent laws. As is well-documented, the competent patent practitioner can almost always cast "process" claims into virtually equivalent-in-scope "machine" claims, making the current debate, as a practical matter, largely moot.[12]

This is not to say that questions do not remain or that the debate should end. For examples:

- What is the scope of the term "article" as a matter of law?
- What constitutes "reducing" as opposed to or in conjunction with "transforming," a distinction not so far addressed?
- What is encompassed by the term "different state or thing," specifically when dealing with bits and bytes?

When all else fails, should one look more closely at the statute? Section 101 expressly requires only that a claimed "process" be "useful" and "new," nothing more. It would seem difficult indeed to conceive of a useful "process," in the thermodynamic sense, in which nothing was "transformed," but this remains to be articulated by the courts or addressed by Congress.

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Endnotes

1 ___F.3d___, 88 U.S.P.Q. 2d 1385 (Fed. Cir. 2008).

2 409 U.S. 63, 93 S.Ct. 253, 1972 U.S. LEXIS 129, 175 USPQ 673 (1972).

3 *Id*. at 70.

4 94 US 780 (1876).

5 *Id*. at 787-88.

6 *Supra* note 2, at 71.

7 450 U.S. 175, 101 S.Ct. 1048, 1981 U.S. LEXIS 73, 209 USPQ 1 (1981).

8 569 F.2d 952, 960, 201 USPQ 352, 360 (CCPA 1979). The first door which must be opened on the difficult path to patentability is § 101.... The person approaching that door is an inventor, whether his invention is patentable or not....Being an inventor or having an invention, however, is no guarantee of opening even the first door. What kind of invention or discovery is it? In dealing with the question of kind, as distinguished from the qualitative conditions which make the invention patentable, § 101 is broad and general; its language is: "any process, machine, manufacture, or composition of matter, or any improvement thereof." Section 100(b) further expands "process" to include "art or method, and a new use of a known process, machine, manufacture, composition of matter, or material." If the invention, as the inventor defines it in his claims (pursuant to § 112, second paragraph), falls into any one of the named categories, he is allowed to pass through to the second door, which is § 102; "novelty and loss of right to patent" is the sign on it. Notwithstanding the words "new and useful" in § 101, the invention is *not examined under the* [§ 101] *statute for novelty because that is not the statutory scheme of things* or the long-established administrative practice. The Committee Reports accompanying the 1952 Act inform us that Congress intended statutory subject matter to "include anything under the sun that is made by man." (Emphasis added.)

9 AT&T Corp. v. Excel Communications, Inc. 172 F.3d 1352 (Fed. Cir. 1999).

10 *Supra* note 1, at 23.

11 149 F.3d 1368 (Fed Cir. 1998).

12 *See* Richard H. Stern, *Tales from the Algorithm War:* Benson *to* Iwahashi*: It's* Deja Vu *All over Again*, 18 A.I.P.L.A. Q.J., 371, 377-78 (1991).

Response: David L. Applegate

I am pleased to see that someone has read my recent article, "*In re Bilski*: Business Method Patents Transformed?" (*Engage* 10, no. 1) with enough care to offer a response; the title of this publication is, after all, *Engage*. I am equally pleased to have this opportunity for rebuttal.

In his commentary above, E. Alan Uebler takes issue with my conclusion that "The *Bilski* majority has given us a test… that is easy enough to state, but perhaps difficult to apply:

unless and until *Bilski* is reversed, overruled, or clarified, to be potentially patentable under 35 U.S.C. § 101, a 'process' must involve either a 'machine' or a 'transformation' from one physical state to another."[1] It is clearly my use of the word "physical" in connection with "transformation" that provoked Professor Uebler's response, but that juxtaposition was *Bilski*'s, not mine.

"[W]hile U.S. Supreme Court and Federal Circuit jurisprudence require that patent claims directed to a 'process' be tied to a 'machine' or involve 'transformation of an article to a different state or thing' in order to qualify as patentable subject matter under § 101." Mr. Uebler concedes this point, but asserts that "there is no requirement that such a transformation be 'physical'." Thus, he continues, "[t]he assertion that a 'physical transformation of matter' must be present overly restricts the Supreme Court mandate and adds to the already abundant confusion in the wake of *In re Bilski et al.*"

To the extent Mr. Uebler means to argue that *Bilski* is—strictly speaking—not "controlling precedent" concerning patentability under § 101, I take no issue, never having asserted otherwise. My conclusion explicitly recognized that the Supreme Court or the Congress—not the Federal Circuit—is the final arbiter of patentable subject matter under 35 U.S.C § 101 by acknowledging that the Federal Circuit may be "reversed [or] overruled," or even that it might "clarif[y]" its own position.[2] Indeed, Mr. Uebler agrees that "[i]t would seem difficult indeed to conceive of a useful "process," in the thermodynamic sense, in which nothing was 'transformed,' but [that] this remains to be articulated by the courts or addressed by Congress."[3] The point of my article, however, was neither what the Supreme Court nor the Congress says on the subject, but rather how *Bilski* has interpreted the statute passed by Congress in view of applicable Supreme Court precedent.

To the extent that Mr. Uebler argues that my conclusion overstates *Bilski*'s holding, I agree with him that the "transformation" *Bilski* requires need not be "physical"—as opposed to, say, "chemical"—but *Bilski* explicitly requires on its face something more than "purported transformations or manipulations simply of… legal obligations or relationships, business risks or other such abstractions."[4] The reason such "transformations or manipulations" of "abstractions" are "ineligible" for patent protection, in *Bilski's* words, is because those abstractions "are not *physical* objects or substances, and they are not representative of *physical* objects or substances."[5] Thus, *Bilski* continued, "claim 1 [of the *Bilski*] application does not involve the transformation of any *physical* object or substance, or an electronic signal representative of any *physical* object or substance."[6] I therefore reiterate my view that, until reversed, overruled, or "clarified," *Bilski* says that §101 requires transformation and reduction to a "different state or thing" in some "physical"—as opposed to "metaphysical" or "abstract"—sense for a process claim that does not involve the use of a machine. There is simply no other way to read *Bilski*.

It is certainly true, as Mr. Uebler asserts, that in *Diamond v. Diehr*[7] the majority had no business going beyond the "machine" requirement—because that had already been met—to invoke the "transformation" prong of *Gottschalk v. Benson*.[8] But that is the Supreme Court's fault, neither *Bilski*'s nor mine. And as Mr. Uebler also acknowledges, *Diehr* came nine years after *Benson*, which had already decided that "[t]ransformation and reduction of an article 'to a different state or thing' is *the* clue [not merely "a" clue] to the patentability of a process claim that does not include particular machines."[9] It is the Supreme Court's language in *Benson* on which *Bilski* ultimately relied for its own holding, and that I emphasized in my article.

In half a dozen places, usually citing Supreme Court authority, *Bilski* explicitly refers to "transforming or reducing an article to a different state or thing" or "transformation and reduction of an article to a different state or thing" as critical to patentability of a process that is not tied to use of a machine.[10] In roughly a dozen more, *Bilski* therefore reiterates that one determines the patentability of a process under § 101 by the "machine-or-transformation" test.[11] If a process patent does not involve the use of a machine, therefore, *Bilski* requires a transformation to a different state or thing, involving a *physical* object or substance.

Mr. Uebler, meanwhile, does not go quite far enough in saying that to satisfy § 101 under *Benson,* a process claim must either "include a particular machine" or "necessitate[] further inquiry."[12] Under *Benson* and *Bilski*, the necessary further inquiry is precisely whether the process "transforms a particular article into a different state or thing."[13]

In the end, Mr. Uebler correctly points out that *Bilski* leaves many unanswered questions, including the meaning of "a different state or thing" when dealing with "bits and bytes."[14] Perhaps the Supreme Court, having agreed on June 1, 2009, to accept Bilski's petition for certiorari in *Bilski v. Doll*, No. 08-964, will answer some of those questions. In the meantime, I thank Mr. Uebler both for his insights and for affording me the opportunity to clarify my own comments.

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Endnotes

1 10 Engage: J. Federalist Soc'y Practice Groups 1, 69 (2009).

2 *Id.*

3 *Id.* at 101.

4 *In re Bilski*, 88 U.S.P.Q.2d at 1398.

5 *Id.* (emphasis added).

6 *Id.* (emphasis added).

7 450 U.S. 175, 101 S.Ct. 1048, 1981 LEXIS 73, 209 USPQ 1 (1981).

8 409 U.S. 63, 93 S.Ct. 253, 1972 U.S. LEXIS 129, 175 USPQ 673 (1972).

9 409 U.S. at 70 (emphasis added).

10 *See, e.g.,* 88 U.S.P.Q.2d at 1392, col. 1; 1392, col. 2; 1392, n. 12; and 1398.

11 *See id.* at 1391, n.8; 1392, col. 1-2; 1393; 1394; 1395; 1396; 1397; 1398.

12 *Supra* note 1, at 89.

13 *Bilski* at 88 U.S.P.Q. 1391, citing *Benson*, 409 U.S. at 70 ("Transformation and reduction of an article 'to a different state or thing' is the clue to the

patentability of a process claim that does not include particular machines."); *Diehr,* 450 U.S. at 192 (use of mathematical formula in process "transforming or reducing an article to a different state or thing" constitutes patent-eligible subject matter); *Flook*, 437 U.S. at 589 n.9 ("An argument can be made [that the Supreme] Court has only recognized a process as within the statutory definition when it either was tied to a particular apparatus or operated to change materials to a 'different state or thing'"); and Cochrane v. Deener, 94 U.S. 780, 788 (1876) ("A process is... an act, or a series of acts, performed upon the subject-matter to be transformed and reduced to a different state or thing.").

14 *Supra* note 1, at 90.

International Law & National Security

Self-Protectionism: The Economics and Politics of Trade

*By Ronald A. Cass**

Although the basic arguments of trade were established more than two centuries ago, they continue to be debated. Protectionism is in the news again as nations struggle with rapidly mounting job losses and plunging industrial production. Almost without exception political leaders and their top-level economic advisers across the globe have publicly endorsed "free trade" principles and warned of the risks to all economies if countries raise trade barriers and cause international trade to fall faster than it would from the effects of declining demand alone. In particular, they have emphasized that such actions would be especially dangerous in the current setting.

Unfortunately, the politics of trade and the economics of trade work to a significant degree at cross-purposes. Politicians may say they embrace free trade, but their fingers are often crossed all the while. Part of the reason for that is an inescapable bias in democratic politics. But another, perhaps very large part is a failure of understanding. Simple as the case for open trade is, its essence escapes most political leaders. The essay that follows explains the basics of trade economics, trade politics, and the problems endemic in making the two fit in the current world economy.

Back to Basics

"I've got a terrible problem with the grocery store—I give them money all the time, and all I get in return is groceries. It's totally unfair!" That's not a conversation you're likely to have with anyone, but it captures the thought behind most politicians' views on international trade. The mercantilist position that dominated seventeenth, eighteenth, and much of nineteenth century thinking about trade saw money as the measure of a nation's wealth. Imports were a source of concern because they had to be paid for with money, which then flowed out of the national treasury. Exports, on the other hand, were good because they brought money into the economy from someone else's treasury.

Adam Smith famously debunked that analysis in *The Wealth of Nations* back in 1776, and his conclusion—that wealth should be measured by the things we have and the value we place on them, not the money we have to buy things with—has long been accepted. Indeed, it is the one proposition about which economists of all stripes agree. The notion that there are "gains from trade" recognizes that we are better off when we trade to get things we value more than what we spend for them. While that costs us money, such trades increase, not decrease, our wealth. We understand that instinctively in our everyday lives. That is why we do not complain about our relationship with the grocery store.

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Although at some level everyone now understands that money is not the best measure of wealth or well-being, public conversations about trade proceed as if it were. From a political standpoint, little has changed from the heyday of mercantilism: we hear that exports are good, imports are bad, and having more exports than imports is a terrible thing, presumptively showing that someone is behaving unfairly to produce that awful result. When politicians talk about "unfair" trade, they strictly mean trade that increases *our* imports or decreases *our* exports: it is unfair if someone winds up with more of our money and we only get more things.

But, of course, *things* are what we want; they are what we work to have. The sensible goal for people or nations is not to have a pile of money you do not spend, but to have what it takes to get what you want. We do not buy things so we can work—we work so we can buy things. The international trade corollary of this proposition is that we *want* imports, and we export to earn money to pay for imports. Imports are things we get to keep, like groceries, and exports provide a flow of money that the people we buy our imports from will accept in exchange. Even in a world where floating currency values are influenced more by economic performance than by stocks of precious metal, the logic of the case for valuing imports and supporting free trade holds true, and it essentially the same for the United States or the European Union as it is for Burundi or Bangladesh.

The Economics of Trade Politics

Yet this is not the way that most politicians understand trade. They view imports with suspicion and support open trade only when persuaded that opportunities for increased exports more than offset the harm from allowing imports. To a great degree, the politics of trade looks a lot like the economics of trade circa 1750.

While political discussions often seem stuck in the mercantilist mindset, the typical political view of trade is not wholly without analytical basis. For one thing, money does matter. While bilateral trade flows do not matter anymore than my bilateral trade flow with the grocery store, overall trade flows do have consequences. A sustained imbalance of imports over exports has implications for the value of a nation's currency as well as for its foreign currency reserves (which in turn affects a nation's ability to make purchases from abroad). Even though the rest of the world has been willing to lend America vast quantities of their people's savings at low cost, U.S. trade imbalances have produced debts that will have to be paid off in the future. Those debts could be paid down by earnings from productivity increases (including increases made possible by capital investments financed through borrowing). More likely, payments will come from taxing future generations to retire debt or from erosion of the currency's value, which then limits economic options in other ways.

Yet this cost of trade imbalances is poorly understood and plays an exceedingly small part in trade politics. The far larger concern for politicians is that trade affects employment. The typical political view is this: imports compete with domestically produced goods and hence replace domestic production; exports, on the other hand, increase employment by expanding domestic production. Both conclusions are mainly wrong. Domestic employment depends on total demand for labor, what our workers do especially well, how our productivity compares with that of other workers, how our capital investments fit with labor needs here, and a host of other factors not captured in the simplistic model of employment and trade common to politics. Since the days of Adam Smith and David Ricardo, we have operated from the basic economic insight that letting everyone specialize in what they do best and facilitating exchange so that everyone has access to the widest array of products is the best way to expand markets, spur competition, and improve output. That produces the best use of our own resources, including the energies of our workers, and ultimately produces the highest incomes and best employment opportunities for our workers. Exports are a part of this—often an important part. Exports tend to be the most efficient, world-class products, and export industries often provide valuable employment opportunities for workers. Look at the world markets for global brands such as Caterpillar, Coca-Cola, Intel, Microsoft, or any number of others. The mechanism by which export success contributes to overall economic success is part and parcel of a competitive process that rewards the most efficient and innovative firms—it is not the result of an "add on" to other economic activity.

The case for open trade, however, is not absolute. Two important economic arguments urge exceptions to the general rule. First, nations with large internal economies can at times improve their position through trade restrictions that decrease the prices charged to their consumers, essentially extracting better "terms of trade." This is the international equivalent of Wal-Mart using its economic muscle to negotiate better terms for what it buys. While theoretically sound if it could be done without repercussions, politicians almost never advocate trade restrictions best explained on this ground.

Second, economic writing over the past three decades has explored ways in which trade restrictions might create world-beating businesses by helping domestic firms capture economies of scale. These facilitate lower prices and better sales of goods with high up-front costs—research and development, for instance—and low marginal costs. Many high-technology markets have substantial economies of scale. Some also show "network effects"—making products more valuable as more people use them (think of telephones or shared computer software, for example). In certain specific settings, trade restrictions *could* assist highly efficient domestic firms to succeed in the "winner take all" (or winner-take-most) markets with these characteristics.

But trade restrictions, even in these markets, do not assure success (especially in a world where others can adopt retaliatory restraints of their own) or guarantee that any jobs gained for domestic firms will be in the domestic market. And the theory does not match up well with the trade restrictions nations actually have, even in the "right" markets. Mainly, trade restrictions in winner-take-most markets prop up inefficient firms rather than facilitating gains by efficient ones—in part because firms that are not as efficient or innovative in product markets often are better at the tasks needed to secure protection against competitors.

While much academic time and energy has been devoted to the theory, in the political realm these explanations are more often excuses seized on to justify restraints prized on other grounds. Generally, economic analysis supports the position that free trade tends to generate more employment and more value for workers as well as for consumers.

The Politics of Trade

Real world trade restrictions most often have a different explanation: they preserve inefficiencies at the expense of job growth and economic advantage to serve narrower political interests. Politicians are notoriously responsive to the concerns of groups most intensely interested in specific issues. These are the people who will raise money to influence political decisions, speak out on those issues, and turn out to vote for or against politicians based on their positions on those issues. This asymmetry tends to favor producers over consumers. We all want access to a wide array of foods at low prices—more choices, better products, lower cost is the set of interests consumers would demand if we were organized and motivated. But it is easier to get a relatively small group of farmers or workers organized and motivated; their interests typically are served by reducing choices and increasing prices. As a rule, no one, not even those at the most successful enterprises, *wants* competition. Successful businesses tolerate it, adapt to it, and profit from being better than their rivals. They invest in innovating and marketing both products and processes to get ahead. Less successful enterprises invest in reducing competition.

Trade is the ultimate form of competition. While, overall, competition brings benefits no other system has been able to match, that is scant comfort to anyone forced to make difficult, sometimes personally devastating changes to adapt to competition. Political forces incline to insulating potentially losing parties against those changes, especially when competition has a foreign face. Tariffs, relatively visible trade barriers, still are used by many developing nations to protect domestic industries. Most other hurdles to open trade are harder to see. Both developed and developing nations impose special licensing requirements on imported goods, tailor technical standards to disadvantage market-leading foreign products, and use competition law regimes to discourage competition by strong foreign firms. They encourage exports through rebate programs, impose health and environmental standards that lack scientific support, limit protections for the intellectual property of innovative firms, and exploit other regulatory and financial tools to favor domestic producers over more efficient foreign competitors. Even where legal regimes look neutral on their face, administrators often tilt their application toward domestic favorites.

Protectionism in Difficult Times

Politicians support these restrictions on trade even while inveighing against protectionism. The threat of reciprocal trade restrictions haunts discussions of steps nations should take to

combat the current economic crisis, with a 1930s style global trade contraction—trade fell by two-thirds in just five years—as the nightmare scenario no one wants to repeat. Look at the joint pronouncements issued after the November 2008 meeting of G-20 presidents and prime ministers or the April 2009 G-20 summit in London. But few of the leaders mean quite what they say in group settings like this, and fewer yet will take the hard steps needed to back up their rhetoric.

Far from evaporating in the face of financial distress, the protectionist instinct grows stronger in bad times. Thus, the World Bank found that, in the first few months following agreement among G-20 leaders to eschew protectionist measures so they could combat the global economic crisis together, at least 17 of the 20 nations imposed new protections for domestic industry and agriculture. Argentina imposed new licensing requirements on auto parts, toys, and leather goods. Indonesia limited imports of clothes, shoes, electronics, and food to just a few ports. The United States adopted a "Buy American" provision, though less sweeping than originally proposed, as part of its most recent stimulus plan. Russia placed new tariffs on auto imports. China banned Irish pork imports and limited other food imports. India banned toys from China. Both India and China increased export subsidies. France made it harder for foreign firms to take over French ones. And nearly every nation has given subsidies to industries to stave off the effects of the downturn, with finance and auto industries prominent recipients of new state aid.

As governments invest vast amounts of public resources in propping up weak businesses and trying to end the downward spiral of de-leveraging, credit contraction, job losses, and reduced consumption, leaders face both popular anger at perceived misuse of taxpayer funds and intense pressure from powerful domestic constituencies—not least, workers who see their jobs at risk. Everyone wants public funds spent where they will be most effective in combating the current crisis—and, even more, where the money has greatest prospect of coming back to them. Few voices express sympathy for spending that advantages foreigners. The thought is that we're spending *our* money to fix *our* economic problem—let them take care of their own. The public is not clamoring to cut off trade, and does not want to spark a trade war, but both the broader public and intensely interested groups strongly support measures to tilt public money their way. The Buy American provision and President Nicolas Sarkozy's call for French automakers receiving government funds to safeguard jobs in France are examples. With governments increasingly intertwined with once-private firms, new requirements at odds with open trade—even if not boldly violating international legal obligations—inevitably proliferate.

Paradoxically, these steps are being taken at a time when the economic case for trade protection has grown weaker. Expanded international trade and finance over the past half century, and especially the past quarter century, have largely undermined the plausibility of seeing competition in us-versus-them terms. World trade has grown every year since 1982; today it is nearly double what it was a half century ago relative to world GDP and roughly 120 times as great in nominal terms. Global trade and finance flows reflect the way businesses work. Firms routinely disperse production across nations. American companies rely on output from China and Japan, Germany and Mexico, Canada and Korea, Ireland and India and Italy to fill out product lines and provide components for "American made" products. Likewise, American firms supply equipment, services, and parts to firms based overseas. It is entirely common today to have components from three or four or five nations assembled in another country based on design work from yet another. Finance flows make investors from many nations stakeholders in almost any global business's success—or, as current events show, partners in its failures. The concept of a uniquely American or French or Japanese product is largely an anachronism.

Yet sensitivity to job losses in industries visibly competing with imports still prompts protectionist responses. Job losses are growing everywhere, and the cascade of protectionist reactions is growing as well. Most political leaders want to keep trade open only as needed to maintain export opportunities and protect jobs in export industries. That is *a* reason to promote open trade, but it does not provide a secure base for fighting against protectionist impulses. Few political leaders understand why trade should matter to ordinary people and to the broad array of workers whose jobs depend on letting markets work—not just to those who benefit directly from open trade but also to those who benefit in a thousand less visible ways from the increased choices, improved products, and reduced costs that competition spurs. Promoting growth in highly advanced economies and generating growth in developing ones are goals almost always synonymous with more open trade. But politics follows economics only so far. While common sense may protect us from cutting off trade with our grocery store for its "unfairness," that is not enough to guarantee the right outcome at the national level, especially when economies are teetering and popular passions are simmering. More than 230 years after Adam Smith, keeping protectionism at bay remains a challenge far more serious than getting a good press statement at a summit.

Labor and Employment Law

EFCA's *Other* Provisions

*By Homer L. Deakins, Jr.**

Employees in America have long enjoyed and exercised the right to a secret ballot election when deciding whether to be represented by a union. But union leaders are now pushing to end secret ballot elections as part of a comprehensive labor reform bill labeled the Employee Free Choice Act (EFCA). EFCA is more popularly known as the "card check" law. This is because EFCA requires employers to recognize a union if a majority of workers sign cards "authorizing" it as their representative. The remaining employees will then be governed by a union regardless of their views. Under card check, all employees lose the opportunity of debating the pros and cons of union representation, as well as the right to vote their true feelings in the privacy of a polling booth.

As the controversy of eliminating secret ballot elections has become more widely known, a few Democrat Senators have reconsidered their support of EFCA. Senate leaders are even suggesting that some compromise be reached, preserving a measure of the current secret ballot process in exchange for passing the rest of EFCA.

But flying under the radar screen of public debate are several other provisions in EFCA whose little discussed changes are far more important to the long-term interests of labor unions than the elimination of secret ballot elections.

First, EFCA grants to government agents the power to dictate wages, hours, and working conditions. Under current law, neither an employer nor a union can be compelled to reach an agreement with the other party. In contrast, EFCA requires that an employer and union reach an agreement within approximately 120 days after the union is certified as the bargaining agent of employees. If no agreement is reached, a federal agency will appoint a panel of "interest arbitrators," who will then make binding decisions regarding salaries, health insurance, hours worked, whether the employer must make contributions to union-controlled pension funds, whether employees must join the union and pay union dues, the scheduling of vacations, and all other related issues.

EFCA provides no standards for future interest arbitrators to follow. Instead, these government appointees will have unfettered discretion to establish work place rules and mandate what owners must allocate to labor costs. Employee ratification of the terms is not permitted, and there are no appeals.

A second change concerns fines and damages that can be awarded against employers. Under current law, improper acts by employers or unions are called unfair labor practices. If an employer or union commits unfair practices, the offending party will be ordered by an administrative judge to stop its unlawful conduct. In addition, if an employer fires an employee for supporting a union, he will be ordered to make the employee "whole" by ordering his reinstatement and awarding full back pay.

EFCA changes the equitable remedial scheme by authorizing the punishment of offending employers. Fines up to $20,000 per unfair practice are permitted. Further, in cases involved alleged wrongful discharges, the employer may be ordered by an administrative judge to pay a discharged employee back pay *plus* two times that amount as "liquidated damages." None of these new remedies apply to unions.

Should employers, but not unions, be fined for equivalent misconduct? What about a jury trial under the Seventh Amendment if a government official can award the equivalent of capped punitive damages? Where is the constitutional right of both sides to make their own contract decisions as guided by respective interests? Is it due process of law when government appointees set the salaries that private business owners must pay? Does the government have the power to transfer wealth from private party "A" to private party "B" for a non-public use? And can this be done without paying just compensation to the victim of the "transfer"?

In 1937, current labor law, originally called the Wagner Act, survived constitutional challenge in the case of *NLRB v. Jones and Laughlin Steel*. The vote was 5-4. The bare majority defended its holding because the Wagner Act did not "compel agreements between employers and employees." Unlike the Wagner Act, however, EFCA compels employers and unions to accept contracts set by the government. Thus, if you the reader conclude, through the exercise of your common sense, that a law like EFCA could never possibly be considered constitutional in our country, applicable Supreme Court precedent supports your way of thinking.

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Litigation

Public Nuisance Litigation against Subprime Industry Hits Roadblock in Cleveland

*By Brian P. Brooks**

Over the past decade, elected city officials around the country have attempted to achieve political goals, and to fill municipal coffers, by suing unpopular industries for damages because they have supposedly caused a "public nuisance." That is not hyperbole—these cities have sued entire industries, not merely particular companies. Invoking the "public nuisance" theory, city governments from Chicago to Philadelphia to St. Louis have sued gun manufacturers, companies that once made lead paint, and others in an attempt to use the litigation process to shut down industries engaged in lawful but locally unpopular businesses. Although most such lawsuits were dismissed as legally meritless in the early part of this decade, the City of Cleveland in 2008 decided to take a turn at the wheel by suing virtually every major participant in the subprime mortgage industry. U.S. District Judge Sara Lioi of the Northern District of Ohio has now dismissed the Cleveland action in its entirety,[1] leaving industry observers to speculate on whether Judge Lioi's decision will deter other cities from filing similar actions.

The City of Cleveland's original complaint against the subprime mortgage industry named 21 defendants, representing every segment of the market. The complaint asserted claims against mortgage companies that originated loans using lines of credit from Wall Street investment houses, commercial banks and thrifts that originated large volumes of mortgage loans, investment banks that both provided financing for mortgage lenders and assisted in the process of "securitizing" pools of loans so they could be sold as mortgage-backed securities to investors, and others. The city alleged a variety of injuries that supposedly flowed from high foreclosure rates, ranging from increased police and fire department costs to a depressed local tax base. But the city made no effort at all to identify any particular foreclosure to any particular form of economic injury (a particularly problematic pleading problem given that Ohio is a judicial foreclosure state, where individual foreclosures are reviewed and approved by courts). Instead, the complaint attacked the overall process of subprime mortgage lending and securitization, a process the city summarized in its complaint as follows:

> (1) WALL STREET made financing available to sub-prime lenders, which
>
> (2) used the cash to make sub-prime loans to consumers, then
>
> (3) sold the related mortgages back to WALL STREET, which
>
> (4) packaged and resold them to investors in the form of mortgage-backed securities, and
>
> (5) used the proceeds to repeat the process.

The city's bold, capitalized references to "Wall Street" strongly signaled its view that there was something inherently wrong with the intersection between the global capital markets and local consumer lending, notwithstanding the direct connection between the growth of the mortgage securitization markets and the significant increase in national homeownership rates since the early 1990s. The complaint made that suspicion explicit, alleging that "[i]n 2003, a fundamental shift took place in how Wall Street constructed their securities offerings backed by subprime mortgages. By that juncture, the demand for [subprime mortgage-backed securities] had grown so significantly that the offerings essentially involved 'money seeking borrowers.'" According to the city, the expansion of subprime mortgage lending to borrowers farther and farther down the credit spectrum made an increase in foreclosure rates inevitable (or at least foreseeable), and thus constituted a public nuisance.

The Cleveland complaint was filed in early 2008 against a backdrop of public nuisance case law that was almost uniformly unfavorable to the city's legal theories. State supreme courts in Illinois, New Jersey, Rhode Island, Missouri, and the District of Columbia, along with numerous other courts, had squarely rejected the idea that entire industries could be held liable under a public nuisance theory without establishing both that particular industry participants had caused injury to a "public right" (as opposed to merely causing private property damage or economic loss) and that the conduct of specific defendants proximately caused specific instances of damage.[2] While the Ohio Supreme Court early on had taken a more accommodating posture with respect to public nuisance actions against gun manufacturers,[3] its decision in the gun context was legislatively overruled long before Cleveland filed its lawsuit against the subprime mortgage industry.[4]

Within a few days after the complaint was filed, the defendants removed the action to federal court. Somewhat surprisingly, although the city had sued 21 different defendants, it had failed to name as defendant any Ohio citizen. (The city's elected officials presumably had political reasons for not wanting to name any of the several large Ohio financial institutions as defendants in the case.) The defendants therefore invoked diversity jurisdiction as the basis for removal. The city fought hard to have the case remanded to state court, making such adventurous arguments as that some of the defendants filed their consents to removal only after the removal was effectuated, and that some of the defendants' consents were executed by in-house counsel who were not their company's chief legal officer and thus may not have had authority to give consent on behalf of the company. After briefing and submission of affidavits concerning the authority-to-consent issue, the district court denied the city's remand motion and proceeded to consider the merits of the case.[5]

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The district court's opinion dismissing the city's lawsuit draws from prior public nuisance cases against other industries, but also breaks some new legal ground. The district court initially considered whether the city's public nuisance claims are preempted by an Ohio state statute that precludes municipalities from undertaking "[a]ny ordinance, resolution, or other action" to "regulate, directly or indirectly, the origination, granting, servicing, or collection of loans."[6] The city argued that it merely sought money damages from the defendants, and thus was not attempting to "regulate" the subprime mortgage industry. Judge Lioi rejected this argument, noting the U.S. Supreme Court's repeated holding that "regulation can be as effectively exerted through an action for damages as through some form of preventive relief."[7] She also noted that, but for a generalized public interest in regulating subprime mortgage lending, the city could not establish the critical "public right" element of its nuisance claim, since a claim of public nuisance is not available to redress purely private injuries such as property damage or economic loss.[8]

Independent of the state statutory preemption problem, Judge Lioi held that the city failed to make out the elements of a public nuisance claim as a matter of common law. As an initial matter, the court ruled that the economic loss doctrine—a doctrine that precludes recovery in tort of purely economic losses that are not accompanied by physical injury—bars claims for public nuisance. The city had asked the court not to apply the economic loss doctrine on the ground that it did not bar the Ohio Supreme Court from affirming public nuisance claims against the gun industry in the *City of Cincinnati* case, but Judge Lioi observed that the economic loss doctrine was not even raised in that decision. More persuasive, she held, was the fact that the only two Ohio decisions to directly address the matter (both of which were decided after *City of Cincinnati*) agreed that the economic loss doctrine applies to nuisance claims.[9]

The court also held that the city's allegations could not establish an unreasonable interference with a public right, as required to state a claim for public nuisance. The court was particularly influenced by the fact that the challenged subprime mortgage products were not only lawful, but affirmatively regulated and encouraged by various federal and state regulators. Judge Lioi noted that in 2000 the U.S. Department of Housing and Urban Development (HUD) released a report encouraging Fannie Mae and Freddie Mac to expand into the subprime market because doing so "could be of significant benefit to lower-income families, minorities, and families living in underserved areas."[10] Four years later, another HUD report found that the growth in subprime lending had indeed delivered significant benefits to credit-impaired borrowers.[11] And, as part of a national effort to make credit more available in communities that had traditionally lacked access to home mortgages, the court noted that "the federal government has enacted numerous laws and issued significant regulatory guidance specifically aimed at encouraging lending to traditionally underserved segments of the population."[12] Under established law, activity that is specifically authorized and regulated by law cannot constitute an "unreasonable interference with a public right."[13]

Finally, the district court concluded that the city's complaint foreclosed any possibility of showing proximate causation. This holding came as no surprise to anyone who read the complaint, which affirmatively alleged that the rising foreclosure rate in Cleveland has been caused by "the City's struggling, Rust-Belt economy, the fading prominence of the manufacturing sector, and Cleveland's challenges in attracting a meaningful replacement," among other things. In addition to these factors, the court concluded that the city could not satisfy the causation requirement because "the City's losses are... contingent upon the insolvency (or inability or unwillingness to repay) of non-parties—namely, the subprime borrowers whose homes were foreclosed and became fire hazards, eyesores, etc."[14]

One would think that Judge Lioi's 36-page opinion dismissing the Cleveland action in its entirety would deter future municipal lawsuits seeking to recover damages against the subprime mortgage industry on a public nuisance theory. The history of municipal lawsuits against other industries, however, suggests that a single dismissal ruling, however well reasoned, will not end the litigation onslaught. A subprime mortgage lawsuit including fair lending claims brought by the City of Baltimore against Wells Fargo Bank is currently pending, and other lawsuits either have been filed or reportedly will be filed in the near future by the cities of Atlanta and Birmingham, with others reportedly weighing their litigation options. These developments suggest that elected city leaders still see political advantage, not to mention potential financial benefits, in attacking an unpopular industry, however weak their claims may be in light of established precedent.

Endnotes

1 *See* City of Cleveland v. Ameriquest Mortgage Sec., Inc., 2009 U.S. Dist. LEXIS 41303 (N.D. Ohio May 15, 2009).

2 *See, e.g.,* Rhode Island v. Lead Indus. Ass'n, 951 A.2d 428 (R.I. 2008) (dismissing public nuisance claim against lead paint manufacturers); City of St. Louis v. Benjamin Moore & Co., 226 S.W.3d 110 (Mo. 2007) (affirming lower court's dismissal of public nuisance claim against manufacturer of lead paint); *In re Lead Paint Litigation*, 924 A.2d 484 (N.J. 2007) (dismissing public nuisance claim against lead paint manufacturers); District of Columbia v. Beretta, U.S.A., Corp., 872 A.2d 633, 647 (D.C. 2005) (refusing "to recognize a claim of common-law public nuisance that disregards, or greatly dilutes, the liability-limiting factors"); City of Chicago v. Beretta U.S.A. Corp., 821 N.E.2d 1099 (Ill. 2004) (dismissing city's and county's public nuisance claim against handgun manufacturers).

3 *See* City of Cincinnati v. Beretta U.S.A. Corp., 768 N.E.2d 1136 (Ohio 2002).

4 *See* Ohio Rev. Code § 23071(A)(13)(c).

5 *See* City of Cleveland v. Deutsche Bank Trust Co., 571 F. Supp. 2d 807 (N.D. Ohio 2008).

6 Ohio Rev. Code § 1.63.

7 San Diego Bldg. Trades Council v. Garmon, 359 U.S. 236, 247 (1959); *see also, e.g.,* Riegel v. Medtronic, Inc., 128 S. Ct. 999, 1008 (2008); Cipollone v. Liggett Group, Inc., 505 U.S. 504, 521 (1992).

8 *City of Cleveland*, 2009 U.S. Dist. LEXIS 41303, at *18-19.

9 *See* Ashtabula River Corp. Group II v. Conrail, Inc., 549 F. Supp. 2d 981, 987-88 (N.D. Ohio 2008); RWP, Inc. v. Fabrizi Trucking & Paving Co., 2006 Ohio 5014, 2006 WL 2777159, at *3 (Ohio App. 8th Dist. 2006).

10 *City of Cleveland*, 2009 U.S. Dist. LEXIS 41303, at *49 (quoting 65 Fed. Reg. 65044, 65106 (Oct. 31, 2000)).

11 *Id.* at *49-50.

12 *Id.* at *47.

13 *See* Allen Freight Lines, Inc. v. Consolidated Rail Corp., 595 N.E.2d 855 (Ohio 1992).

14 *City of Cleveland*, 2009 U.S. Dist. LEXIS 41303, at *63.

Professional Responsibility & Legal Education

Does the Attorney-Client Privilege Cover a Law Firm's Consultation with In-House Counsel About Issues Involving Current Clients?

*By Francis J. Menton, Jr.**

These last two decades have seen the dramatic rise of in-house counsel at large law firms. In 2002, Elizabeth Chambliss and David Wilkins reported that, by the late 1990s, every one of a sample of 32 large law firms had established at least a position of ethics or risk management specialist filled by an in-house lawyer, many having created that position recently.[1] A 2008 survey of the AmLaw 200 firms by the Altman Weil consulting firm found that, by 2004, 63% of them had a designated in-house general counsel; by 2008, that figure had increased to 85%.[2] A key function of such in-house counsel is to consult on conflicts and other ethical issues, many of which involve the firm's current clientele.

Yet, even as law firms rely increasingly on such in-house counsel, a spate of recent court decisions calls into question whether the attorney client privilege can be invoked to protect communications between firm lawyers and in-house counsel, as to matters involving current clients of the firm. To the surprise of many practitioners in the field, the result of each succeeding court decision has been yet another blow to the idea that attorneys at a law firm can consult an in-firm general counsel or ethics specialist regarding a current client with any degree of comfort that the attorney-client privilege will apply.[3]

Although several commentators have been critical of this judicial trend,[4] the very unanimity of the reported decisions suggests that it is not likely that the law on this subject will reverse itself any time soon. Therefore, it is important to analyze the reasoning of the decisions, and from there to assess how far the rule is likely to carry, and how, if at all, a law firm can obtain privileged advice in many sensitive situations that may involve a current client.

The conclusion reached here is that, at least from the time the firm becomes aware of a conflict between its own interest and that of a client, it is probable that the attorney-client privilege will not protect any consultation within the firm as to such a client. Therefore firms in these situations will be well advised to minimize admissions in potentially discoverable writings and, when preservation of the privilege is critical, to consider early retention of outside counsel.

With regard to an appropriate legal framework, this article urges courts to recognize the practical realities of firms attempting to identify and react appropriately to developing conflicts in ongoing situations. Such recognition could take the form of honoring the attorney-client privilege as to in-firm consultation at least for the conflict assessment process and for some reasonable time thereafter while the firm determines how to respond.

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Arguments For and Against an Intra-Firm Privilege in Matters Involving a Current Client

The attorney-client privilege is so entrenched and so widely accepted in our legal system that many practitioners find it quite counterintuitive that there could be a significant arena where a client consults with a lawyer seeking legal advice and the privilege simply does not apply. This is particularly so because the considerations that led to the existence of the attorney-client privilege in the first place—the need for expert legal advice in order to obtain maximum compliance with legal duties, and the need for complete candor in disclosing the facts in order to get the best legal advice possible—apply with the seemingly equal force in the context at issue here.

Nevertheless, the cases discussed below find that, when the consultation is between a firm lawyer and the firm's in-house counsel, and the consultation involves a current client, the usual considerations are trumped by another consideration—namely, the conflict of interest that arises when the firm simultaneously represents its client and itself. The cases find that the in-house lawyer advising the firm is, by imputation, also a lawyer for the outside client; that advising the firm where its interest is adverse to the client is a violation of the rules of ethics, particularly Rule 1.7 of the Model Rules of Professional Responsibility (and its various state counterparts); that the client is therefore within the zone of any otherwise confidential communications among firm lawyers relating to the client; and thus, that neither the in-house counsel nor the remainder of the firm can claim the privilege as against that client.

While that is one possible chain of logic, starting from first principles it is not obvious that a firm's advising itself with respect to a current client situation would or should entail vitiation of all attorney-client privilege due to the inherent conflict of interest. In 2005, the New York State Bar Association Committee on Professional Ethics explicitly stated that such a situation does not necessarily create a conflict of interest at all,[5] adding that a "law firm is not only entitled, but required, to consider the ethical implications of what it does on a daily basis"[6] and that expecting a firm to always seek outside counsel when potential conflict situations arise is "simply impractical."[7]

It is further not obvious, even assuming a conflict exists, that the attorney-client privilege would or should be destroyed by it. Indeed it could well be that a general rule providing for no attorney client privilege for the firm in such a situation is not in the overall best interest of the clients.[8] Denying attorney-client privilege to firms for in-house consultation as to any current client situation could likely lead to one or all of three results: (1) firms minimizing communications, and particularly writings, in the process of conflict assessment and response, (2) early retention of outside counsel, and/or (3) encouraging firms more frequently to seek to withdraw from

the client relationship in ambiguous situations. As to the first result, a less robust communication process could well lead to less robust and accurate assessment of conflicts and compliance with responsibilities. That is exactly the reasoning that supports the existence of an attorney-client privilege in the first place. Since clients have a real interest in accurate compliance with ethics principles, suppressing communication on this subject is potentially as harmful to clients' interests as to firms.' With regard to early retention of outside counsel, clients would likely be generally indifferent, but that still means that significant costs may be imposed on the firm for no identifiable benefit to the client—and the costs may ultimately be passed on to the client. Finally the third potential result, encouraging withdrawal in possibly ambiguous situations, could well cause net harm to clients' interests.

Nevertheless, the cases decided so far appear to turn less on broad consequences of the stated rule of law and more on the unsavory appearance of law firms seeking to position themselves in anticipation of malpractice claims.[9] Since the reported decisions tend to arise out of situations in which the conflict of interest was fairly stark, there is good reason to think that the trend in the case law will continue.

Court Decisions Regarding Intra-Firm Privilege in Matters Involving a Current Client

With four new decisions on the subject in 2007 and 2008, there are now at least eight decisions that consider whether attorney-client privilege can be asserted as to an intra-firm consultation in a matter involving a current client.[10] While most of them recognize that there could be at least some circumstances where a law firm can have privilege on in-house consultation as to a current client, all eight decisions ultimately order, on the facts before them, that discovery must be made over the assertion of the privilege.

The progenitor of this line of cases is *In re Sunrise Securities Litigation*,[11] a 1989 case from the Eastern District of Pennsylvania. Like several later cases, *Sunrise* conceded the possibility that there may be situations in which privilege would be preserved in this context,[12] and even stated that the analysis of privilege must be made on a case-by-case basis.[13] But *Sunrise* ordered documents to be produced at least going forward from the date when an identifiable conflict with the client arose; and all the subsequent decisions have followed it on this point. None of the cases considers the issue of whether identifying the moment when such a conflict has arisen may be difficult in the onrush of real world events.

Sunrise involved consolidated claims of the SEC, Federal Savings and Loan Insurance Corporation, and depositors of a failed savings and loan association (Sunrise) against several defendants, including former officers and directors of Sunrise and the law firm Blank Rome, which had been counsel to Sunrise. Although a lengthy decision covering many issues, the *Sunrise* court's discussion of the question at issue here is short. Director defendants sought document discovery from Blank Rome, including documents relating to legal advice to the firm from in house counsel at the firm. Blank Rome resisted discovery of this category on the ground of privilege. Searching for precedent, the court found none that specifically addressed the situation of a law firm giving itself legal advice about a current client, and therefore relied principally on a case involving a corporate director with conflicting duties, *Valente v. PepsiCo*.[14]

In *Valente*, a 1975 case from the District of Delaware, the court found that a corporate director's conflicting fiduciary duties—on the one hand to the corporation's shareholders as a whole, on the other to the majority shareholder who had named him to the board—vitiated his attorney-client privilege with the majority shareholder.[15] Following *Valente*, the court in *Sunrise* ruled:

> Applied to the situation presented here, the reasoning of *Valente* would dictate that a law firm's communication with in house counsel is not protected by the attorney client privilege if the communication implicates or creates a conflict between the law firm's fiduciary duties to itself and its duties to the client seeking to discover the communication…. The attorney client privilege therefore will protect only those otherwise privileged documents withheld by Blank Rome which do not contain communications or legal advice in which Blank Rome's representation of itself violated Rule 1.7 with respect to a Blank Rome client seeking the document.[16]

Beyond that, however, the court gave no further guidance, and referred the individual documents to a special master for rulings.

Thirteen years later a similar case arose in the same federal district, the Eastern District of Pennsylvania, *Koen Book Distributors v. Powell, Trachtman, Logan, Carde, Bowman & Lombardo, P.C.*[17] In *Koen Book*, the plaintiffs, clients of the defendant law firm, informed the firm in July 2001 that they were considering bringing a malpractice claim against it, but the firm continued to represent the client into August, about a month later. During that month, the firm consulted in-house counsel as to how to proceed, generating in the process some twenty-nine documents that "would clearly have been protected from discovery by the attorney-client privilege… if a third party… sought access to them," but as to the current client were "[p]ermeat[ed]… [with] consideration of how best to position the firm in light of a possible malpractice action."[18]

The *Koen Book* court stated: "My colleague, Judge Thomas O'Neill, faced a like issue a number of years ago in *[Sunrise]*." It then proceeded explicitly to follow the *Sunrise* decision, including the reliance on *Valente*,[19] quoting the following articulation of the common interest exception as the core holding of *Valente*:

> It is a common, universally recognized exception to the attorney-client privilege, that where an attorney serves two clients having common interest and each party communicates to the attorney, the communications are not privileged in a subsequent controversy between the two.... The fiduciary obligations of an attorney are not served by his later selection of the interests of one client over another.[20]

In 2002, in *Bank Brussels Lambert v. Credit Lyonnais Suisse,*[21] the Southern District of New York held that a firm's conflict of interest is always imputed to all lawyers in the firm (including its in-house counsel),[22] and, relying on *Sunrise*, found that a firm has an ethical duty to disclose the results of its internal conflicts checks to a current client.[23] In 2005, in *VersusLaw Inc.*

v. Stoel Rives LLP,[24] the Washington Court of Appeals, again citing to *Sunrise,* acknowledged that "privilege can apply to intra-firm communications," but then held that the existence of a conflict can destroy the privilege as to communications that arise after the conflict; because the record before it was unclear regarding issues of timing, it remanded to allow the trial court to determine more precisely when the conflict between the firm and its current client arose.[25] In 2007, in *Thelen Reid & Priest LLP v. Marland*,[26] the court stated that *Sunrise* was instructive and, after discussing its holding, stated that a law firm's communications with its general counsel regarding a dispute with a current client were not privileged because the firm's fiduciary duty to its client "lifts the lid" on such conflicted communications.[27] The court went on to state:

> Specifically, while consultation with an in-house ethics adviser is confidential, once the law firm learns that a client may have a claim against the firm or that the firm needs client consent in order to commence or continue another client representation, then the firm should disclose to the client the firm's conclusions with respect to those ethical issues.[28]

Also in 2007, in *Burns v. Hale and Dorr LLP*,[29] the District of Massachusetts, discussing *Bank Brussels* and *Koen Book*[30] (both of which relied on *Sunrise*), found that a firm cannot invoke attorney client privilege on behalf of itself as a "client" against one of its current clients, as the conflict between its own interests and the fiduciary duty that it owes its current client vitiates the privilege.[31] In 2008, in *In re SonicBLUE Inc.*,[32] quoting *Sunrise*, the bankruptcy court for the Northern District of California stated that "a law firm cannot assert the attorney-client privilege against a current outside client when the communications that it seeks to protect arise out of self-representation that creates an impermissible conflicting relationship with that outside client."[33]

Finally, in 2008, in *Asset Funding Group v. Adams & Reese*,[34] the Eastern District of Louisiana, citing to *Upjohn Co. v. United States*[35] and *Valente*, and relying explicitly on *Sunrise*,[36] held that "[a]sserting the privilege against a current client seems to create an inherent conflict against that client."[37] This most recent formulation of the rule would seem to reverse the causal relationship between conflict and privilege in a way to imply that the vitiation of in-firm privilege may be inherent as to all current client advice at all times during the relationship, whether or not the advice occurred at a time when an actual conflict between client and firm had or could have been identified.

In assessing how entrenched the rule of *Sunrise* has become, it may be significant that seven of these eight cases were decided in the federal courts,[38] and there is very little state court authority on the subject. Thus a state court may be persuaded to adopt a different rule. However, the one state court case, *VersusLaw*, follows *Sunrise,* just as each of the six post-*Sunrise* federal decisions. None of these decisions goes into much depth as to a fact-intensive conflict analysis (perhaps because the existence of conflicts is clear in these cases) and none questions the proposition that the current client conflict rightfully should vitiate the privilege. None of the cases addresses the extent to which the rule relied on is ultimately beneficial to clients or may create a difficult and even unworkable situation for law firms.

Practical Implications and a Suggested Judicial Approach

The court decisions under discussion have, to date, not included any in-depth analysis of the practical implications of their results. But those implications could be substantial. On the current state of law, there could even be some doubt whether any aspect of the internal conflict or ethics evaluation process at a law firm will receive the protection of the attorney-client privilege as against a current client. A large law firm must evaluate conflicts as to every new matter, and also as to various changes in ongoing matters, and typically makes thousands of assessments and decisions on such issues within a year. A meaningful percentage of these decisions involve close questions and judgment calls. On some such judgment calls, a court may later differ in hindsight, although the firm was proceeding in all good faith. If a court does differ in hindsight, may it then view the entire conflict checking process as adverse to the client from the inception? Such a result would provide very perverse incentives with respect to the duty, expressed in the above-cited New York State Bar Association opinion, that a "law firm is not only entitled, but required, to consider the ethical implications of what it does on a daily basis."[39]

For the law firm seeking to arrive at the best ethical decisions through an unrestrained internal debate, no simple solution presents itself. One recommendation of several commentators has been the creation of a full time, salaried, quarantined position for in-house counsel, the idea being that if counsel is shielded from client interaction and not dependent on profits made from client representation, she is representing only the firm, while the firm's other attorneys are representing only the clients.[40] The hope in using this procedure would be to avoid the imputation of conflict to the quarantined in-house counsel, and thereby preserve the privilege. While a court may be persuaded to allow this approach, no court has yet endorsed it, and nothing in the current case law gives comfort that it will work. There is moreover good reason to suspect that it would not work. Under the Model Rules of Professional Conduct, the general imputation of conflicts among lawyers at a firm applies to salaried lawyers as well as to equity partners and does not turn on whether a particular lawyer works on a particular matter.[41]

That leaves three potential courses of conduct, all with significant potential drawbacks: (1) engage in ethical and conflict analysis defensively, while writing down as little as possible, (2) hire outside counsel at the first hint of a problem, and (3) when in doubt, seek to withdraw. Courses (2) and (3) promise potentially slower decision-making, added expense, and potential disruptions to clients in ongoing matters. But the consequences of action (1) are potentially even worse: less robust consideration and debate of complex issues, leading to less good decision-making; in other words, the consequence at the core of the reason for the existence of the attorney client privilege in the first place. All three of these potential drawbacks could be drawbacks for the clients' interests as well as those of the law firm.

For a court persuaded of the basic correctness of the approach of *Sunrise* and its progeny, there can still be limits on the application of the rule that could minimize some of its

perverse practical consequences. Allow protection under the attorney-client privilege at least for internal law firm discussions and documents constituting the initial and ongoing conflict and ethical evaluation process, if not the results of the process. Give a firm some reasonable amount of time to identify the issue and conduct a process to figure out if it has a problem, before the existence of the conflict will be deemed to vitiate privilege even for the process of figuring out if there is a conflict. Allow this time even if the existence of a conflict at an early date appears obvious in hindsight.

The courts rightly come to these issues with the perspective that their paramount concern should be the protection of the client's interests. But they must take care not to arrive at rules of law that may serve the immediate interest of the client in the case before them, but not the ultimate interest of all clients in the best possible regime of ethical compliance by lawyers.

Endnotes

1 Elizabeth Chambliss & David B. Wilkins, *The Emerging Role of Ethics Advisors, General Counsel, and Other Compliance Specialists in Large Law Firms*, 44 Ariz. L. Rev. 559, 564-5 (Fall/Winter 2002).

2 Altman Weil, 2008 Results of confidential "Flash" Survey on Law Firm General Counsel 1, *available at* http://www.altmanweil.com/dir_docs/resource/f5b642dd-99a1-423a-a6a1-16bdb67a3464_document.pdf.

3 In re Sunrise Securities Litigation, 130 F.R.D. 560 (E.D. Pa. 1989); Koen Book Distributors v. Powell, Trachtman, Logan, Carrle, Bowman & Lombardo, PC, 212 F.R.D. 283, 286 (E.D. Pa. 2002); Bank Brussels Lambert v. Credit Lyonnais, 220 F. Supp. 283, 287 (S.D.N.Y. 2002); VersusLaw Inc. v. Stoel Rives LLP, 111 P.3d 866, 878-9 (Ct. App. Wash., Div. 1 2005); Thelen Reid & Priest LLP v. Marland, 2007 WL 578989, at *6-7 (N.D. Cal. Feb. 21, 2007); Burns v. Hale and Dorr LLP, 242 F.R.D. 170, 173 (D. Mass. 2007); In re SonicBLUE Inc., 2008 WL 170562, at *9 (Bkrtcy. N.D. Cal. Jan. 18, 2008); Asset Funding Group v. Adams & Reese, 2008 WL 4948835, at *2 (E.D. La Nov. 17, 2008).

4 *See, e.g.*, Elizabeth Chambliss, *The Scope of In-Firm Privilege*, 80 Notre Dame L. Rev. 1721 (May 2005); Douglas R. Richmond, *Law Firm Internal Investigations: Principles and Perils*, 54 Syracuse L. Rev. 69 (2004).

5 New York State Bar Association committee on Professional Ethics, Opinion 789, Oct. 26, 2005, *available at* http://www.nysba.org/AM/TemplateRedirect.cfm?template=/CM/ContentDisplay.cfm&ContentID=13638.

6 *Id.*

7 *Id.*

8 *See* Chambliss, *supra* note 4, at 1721, 1747-8.

9 *See, e.g.*, *Bank Brussels Lambert*, *supra* note 3, at 287 (because attorneys must avoid even the appearance of representing conflicting interests, a firm must disclose to its current clients the results of its conflict checks).

10 *Supra* note 3.

11 130 F.R.D. 560 (E.D. Pa. 1989).

12 *See In re* Sunrise Securities, 595 ("I am now persuaded that it is possible in some instances for a law firm, like other business or professional associations, to receive the benefit of the attorney-client privilege when seeking legal advice from in-house counsel.… I am not willing to hold that a law firm may never make a privileged communication with in-house counsel.").

13 *See In re* Sunrise Securities, *supra* note 3., at 597, n.11.

14 Valente v. PepsiCo, 68 F.R.D. 361 (D. Del. 1975).

15 68 F.R.D. 361, 368-9 (D. Del. 1975).

16 130 F.R.D. at 597 (E.D. Pa. 1989).

17 *See Koen Book, supra* note 3.

18 212 F.R.D at 286.

19 212 F.R.D at 284-85.

20 212 F.R.D at 285 (quoting *Valente*, 68 F.R.D. at 368).

21 *See Bank Brussels Lambert, supra* note 3.

22 220 F. Supp. 283, 287-8 (S.D.N.Y. 2002).

23 220 F. Supp. 283, 287 (S.D.N.Y. 2002).

24 *See VersusLaw, supra* note 3.

25 111 P.3d 866, 878-9 (Ct. App. Wash., Div. 1 2005).

26 *See Thelen Reid & Priest.*

27 2007 WL 578989, at *6-7 (N.D. Cal. Feb. 21, 2007).

28 *Id.* at *8 (citing to ABA Model Rule of Prof Conduct 1.7 and N.Y. eth Op 789).

29 *See Burns, supra* note 3.

30 242 F.R.D. 170, 172 (D. Mass. 2007).

31 *Id.* at 173.

32 *In re* SonicBLUE Inc., 2008 WL 170562 (Bkrtcy. N.D. Cal. Jan. 18, 2008).

33 2008 WL 170562, at *9 (Bkrtcy. N.D. Cal. Jan. 18, 2008)

34 *Asset Funding Group, supra* note 3.

35 Upjohn Co. v. United States, 449 U.S. 383 (1981).

36 2008 WL 4948835, at *4 (E.D. La Nov. 17, 2008).

37 *Id.* at *2.

38 *In re* Sunrise Securities, 560; *Koen Book Distributors* 283, 286; *Bank Brussels Lambert,* 283, 287; *Thelen Reid & Priest*, at *6-7; *Burns*,170, 173; *In re* SonicBLUE, at *9; *Asset Funding*, at *2.

39 New York State Bar Association committee on Professional Ethics, Opinion 789 ¶ 12, Oct. 26, 2005, *available at* http://www.nysba.org/AM/TemplateRedirect.cfm?template=/CM/ContentDisplay.cfm&ContentID=13638.

40 *See, e.g.*, Barbara S. Gillers, *Preserving the Attorney-client Privilege for the Advice of a Law Firm's In-House Counsel* Prof. Law. 107, 110-11 (2000); Richmond, *Law Firm Internal Investigations*, 104-106; Chambliss, *supra* note 4, at 1721, 1757-66.

41 American Bar Association, Model Rules of Professional Conduct, Rule 1.10.

Religious Liberties

Conscience Protection in Health and Human Services

*By William L. Saunders & Michael A. Fragoso**

On August 21, 2008, Secretary of Health and Human Services (HHS) Mike Leavitt proposed regulations seeking to protect the rights of conscience for healthcare professionals. While the regulations themselves are new, conscience protection of medical personnel at the federal level dates back to the time of *Roe v. Wade* in the form of the Church Amendments.[1] Conscience rights are protected in two additional components of federal law: the Public Health Services Act § 245 (also known as the Coats Amendment)[2] and the Weldon Amendment.[3] The regulations proposed by Secretary Leavitt, entitled "Ensuring that Department of Health and Human Services Funds Do Not Support Coercive or Discriminatory Policies or Practices in Violation of Federal Law" ("the Regulations"), were an effort to provide a stronger regulatory context for the existing laws.[4]

These long-standing protections of conscience rights for medical personnel, however, are being challenged at home and abroad. In October 2008, for instance, the Australian state of Victoria passed the Abortion Reform Bill without clarifying amendments protecting physicians' conscience, meaning that doctors will potentially lose their medical licenses should they refuse to participate in abortions.[5] In early 2008 similar actions were taken in Ontario Province, Canada, but they largely failed after meeting stiff resistance.[6] Following the inauguration of President Barack Obama, the HHS, on March 10, 2009, issued a notice of proposed rule making to rescind the conscience protection regulations promulgated by President Bush.[7]

Background

In the United States, the most recent challenge to conscience rights came in November 2007. The American College of Obstetricians and Gynecologists (ACOG) issued an opinion (the "Opinion") in which it said that doctors who refused to perform abortions should be required to refer someone seeking an abortion to a doctor who would perform it.[8] The ethical problem is that if one believes a procedure to be immoral, the Act of referring it to someone else makes one complicit in the subsequent immoral act. Conscience protection, surely, means that one cannot be forced to do, directly or indirectly, what one judges to be immoral or unethical.[9]

The American Board of Obstetricians and Gynecologists (ABOG) issued a bulletin in November 2007 on maintenance by obstetricians of certification (the process by which a practicing obstetrician can maintain his professional credentials). The bulletin said certification could be revoked if there is a "violation of ABOG or ACOG rules and/or ethics principles or felony convictions."[10] Further, applicants for certification must sign a statement that they understand they face disqualification in the event "that the physician shall have violated any of 'The Ethical Considerations in the Practice of Obstetrics and Gynecology' currently published by the American College of Obstetricians and Gynecologists and adhered to by the Board."[11]

Therefore ACOG's opinion, if it becomes part of the larger body of ACOG ethical norms,[12] would strip board certification from doctors who refuse to *refer* for abortion, thus effectively denying them hospital privileges and costing them their livelihoods.

Various advocacy groups took issue with the Opinion,[13] and eventually Secretary Leavitt took interest in it.[14] He expressed concern that the Opinion, if put into force as an ethics requirement for obstetricians, would force pro-life obstetricians to refer for abortion in order to maintain their certifications and livelihoods, and thus would run counter to existing federal law protecting the rights of conscience of medical professionals and health care organizations.

ABOG and ACOG responded in a way Secretary Leavitt found "dodgy and unsatisfying."[15]

Existing Conscience Legislation

The earliest federal conscience protections date back to the aftermath of *Roe v. Wade*, and are known as the Church amendments, after the Democratic Senator from Idaho, Frank Church. The four "Church amendments" (two from 1973, one from 1974, and the last from 1979) contain multiple prohibitions on use of federal funds or guarantees regarding abortions, sterilizations, and other medical procedures and activities. The amendments prohibit courts, public officials, and recipients of funds under the Public Health Service Act (PHSA), 42 U.S.C. 201 et seq., the Community Mental Health Centers Act (CMHCA), 42 U.S.C. 2689 et seq., or the Developmental Disabilities Services and Facilities Construction Act (DDSFCA), 42 U.S.C. 6000 et seq., form forcing entities "to perform or assist in a sterilization procedure or an abortion, if it would be contrary to his/her religious beliefs or moral convictions." The amendments also prohibit employment or other discrimination against healthcare personnel because they either participated, or refused to participate, in lawful sterilization procedures or abortions. They also prohibit discrimination in admissions by PHSA-CMHCA-DDSFCA recipients because of an applicant's reluctance or willingness to "counsel, suggest, recommend, assist, or in any way participate" in abortions or sterilizations, due to religious beliefs or moral convictions.

The Church amendments go further than protecting conscience only in the areas of abortion and sterilization. Any recipient of funds administered by the Secretary of HHS "for biomedical or behavioral research" cannot discriminate against health care personnel in employment, promotion, termination, or extension of medical privileges "because [they] performed or assisted in the performance of any lawful health service or research activity, or because he refused to perform or assist in

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the performance of any such service or activity on the grounds that his performance of any such service or activity would be contrary to his religious beliefs or moral convictions, or because of his religious beliefs or moral convictions respecting any such service or activity." The Church amendments are thus very broad in their protection of conscience, protecting the right of the individual to refuse to participate in any health service or research if it is contrary to his or her religion or morals.

The Coats amendment, named for the Indiana Senator Daniel Coats, was enacted by Congress in 1996, and provides protections for entities that refuse to participate in abortion. It was adopted in response to a requirement of the Accreditation Council for Graduate Medical Education that obstetrics and gynecological residency programs provide abortion training. As such, it provides that the federal government as well as any federally funded state or local government may not discriminate against a "health care entity" (defined to include physicians, medical schools, and medical students) if they (1) refuse to receive, provide or require abortion training; (2) refuse to provide abortions; (3) refuse to provide referrals for abortions or abortion training; or (4) attended a training program that did or does not require attendees to perform abortions or require, provide or refer for training in the performance of abortions or make arrangements for such training. Thus, the federal government or any government receiving federal funds may not require an "entity" to provide abortion training for post-graduate accreditation or as a requirement for professional certification or licensing.

The Weldon amendment is an appropriations rider from 2005, written by the retired Florida congressman, Dr. David Weldon, which states that the federal government as well as any federally funded state or local government cannot subject any institutional or individual healthcare entity to discrimination based on the fact that the entity does not "provide, pay for, provide coverage of, or refer for abortions."

Regulations under George W. Bush

Though the Church Amendments date back to the 1970s, there had never been a regulatory rule-making to determine how the conscience protection provided by it and the other two conscience provisions are to work. In response to the ACOG/ABOG controversy, Secretary Leavitt considered issuing regulations protecting medical professionals' rights of conscience, and HHS prepared draft regulations for internal discussion.

The draft was leaked to the *New York Times*, which published them with comments by pro-abortion groups such as Planned Parenthood.[16] The draft regulations made specific reference to pregnancy beginning at conception, and referred to "the termination of the life of a human… before or after implantation."[17] As such, it would have been possible for a "health care entity" (including doctors) to have a conscientious objection to abortifacients (for instance, drugs and devices which might prevent implantation of an embryo, such as Plan B, the birth control pill, and Intra-Uterine Devices).[18] Pro-abortion groups attacked the regulations, claiming they would limit access to contraception. NARAL Pro-Choice America[19] termed it "The Bush Administration's Attack on Birth Control."[20] On the other hand, a letter was sent to Leavitt by 132 members of Congress urging adoption of the regulations.[21]

Secretary Leavitt responded to this on his blog, confirming that regulations were being considered.[22] Pro-abortion activists flooded his comment section. Twenty-five of their blog posts were removed because they included "profane language or personal attacks on [Secretary Leavitt's] body parts, religion or family."[23] Secretary Leavitt summarized the pro-abortion argument as follows: "[I]f a person goes to medical school they lose their right of conscience. Freedom of expression and action is surrendered with the issuance of a medical degree."[24] He insisted that his goal was not to ban contraception or abortion, but to protect conscience—"If the Department of Health and Human Services issues a regulation on this matter, it will aim at one thing, protecting the right of conscience of those who practice medicine. From what I've read the last few days, there's a serious need for it."[25]

On August 21, 2008, ten days after his second blog post, Secretary Leavitt issued a notice of proposed rulemaking ("NPRM") announcing that HHS would, in fact, be filing the Regulations in the Federal Register clarifying federal law on the conscience rights of "health care entities."[26]

The Regulations were meant to bolster the federal legislation mentioned earlier in a manner as robust as possible. The final document notes, "Consistent with this objective to protect the conscience rights of health care entities/entities, the provisions in the Church Amendments, section 245 of the Public Health Service Act and the Weldon Amendment, and the implementing regulations contained in this Part are to be interpreted and implemented broadly to effectuate their protective purposes."[27]

One shortcoming of federal legislation is its ambiguous language—what is meant by "Health Care Entity"? [28] What is meant by "abortion?" The Regulations address some of those concerns: they define "assist in the performance" so as to include referral; they also define "health care entity" broadly.[29]

However, the ambiguous use of the term "abortion" in the federal legislation is not clarified by the Regulations. In the Regulations, it is unclear whether a potentially abortifacient drug such as Plan B would count as the sort of abortion-related procedure for which a medical professional's conscientious objection is protected—the term "abortion" is never defined. It is possible that this definition was omitted from the final regulations due to the furor over the definition of abortion in the leaked draft.[30]

The Regulations spell out the protection for medical personnel from discrimination on a number of conscience-related grounds. First, medical students and practicing physicians are protected from having, "(A) to undergo training in the performance of abortions, or to require, provide, refer for, or make arrangements for training in the performance of abortions; (B) to perform, refer for, or make other arrangements for, abortions; or (C) to refer for abortions…"[31]

Second, students and physicians are protected from discrimination based on the sort of institution in which they received their training. They cannot be subject to discrimination

for having received their training at an institution "that does not or did not require attendees to perform induced abortions or require, provide, or refer for training in the performance of induced abortions, or make arrangements for the provision of such training…"[32]

Lastly, medical personnel cannot be subject to any discrimination pertaining to credentialing or licensing on grounds related to abortion (thus answering the threat posed by the Opinion by ACOG).[33]

The Regulations further mandate that the applicable institutions[34] have to meet established certification standards for compliance.[35] This serves to make affected recipients (such as any state and local governments that receive funds through HHS, or any non-governmental entity that receives funds through HHS) better aware of their existing legal obligations to respect the conscience rights of medical professionals. It also establishes a robust regulatory mechanism for HHS to ensure that these rights are, in fact, being maintained.[36]

The regulations were promulgated on December 18, 2008 and came into force on January 20, 2009.[37]

Objections

The Regulations met fierce opposition by pro-abortion activists and organizations.

The idea of "conscientious objection" to abortion by medical professionals has long been perceived as an obstacle by those seeking to expand access to abortion. Evidence of this can be found in the International Planned Parenthood Federation's lengthy document entitled "Access to Safe Abortion: a tool for assessing legal and other obstacles."[38] This document is intended to be a primer for those seeking to change the abortion laws in countries where abortion is restricted, by showing the typical legal obstacles to abortion and instructing activists how to go about eliminating them. Section 12 of the document is "Conscientious Objection," a concept that "shields providers from liability for refusing to offer services that their patients are legally entitled to receive." These clauses can "deny access to services and violate providers' duty of care to patients." As such any conscientious objector ought to "give notice" to her patients that she objects to certain "care" on moral grounds and be prepared to refer them to those who lack such compunctions.

Likewise the United Nations Committee on the Elimination of Discrimination Against Women has urged state parties to the Convention on the Elimination of All Forms of Discrimination Against Women to eliminate conscience protections in domestic law, claiming they might impede access to abortion. As the Committee commented to Poland, "It also urges the State party to ensure that women seeking legal abortion have access to it, and that their access is not limited by the use of the conscientious objection clause."[39] The Committee made similar objections to Portugal,[40] Italy,[41] and Slovakia.[42]

Such views appeared in some of the comments filed with HHS following the NPRM of the Regulations. The American Medical Association (in conjunction with numerous other groups, including the American Psychological Association, the American Nurses Association, the American Academy of Pediatrics), for exampled, argued that the new regulations ought not to be promulgated because it might "undermine patients' access to medical care and information." Doctors who follow their consciences might violate their "paramount responsibility and commitment to serving the needs of their patients."[43] Likewise 13 state attorneys general issued comments opposing the Regulations,[44] as did the Alan Guttmacher Institute.[45]

Lawsuits

Following the promulgation of the Regulations, Connecticut Attorney General Richard Blumenthal announced his intention to take action against the Regulations,[46] claiming that they violate the rights of Connecticut, which in 2007 passed a law regarding the availability of emergency contraception ("EC") at hospitals.[47]

Blumenthal filed a lawsuit on January 15, 2009 on behalf of Connecticut, California, Illinois, Massachusetts, New Jersey, Oregon, and Rhode Island.[48] Blumenthal had previously spearheaded a group of attorneys-general from thirteen states in submitting comments following HHS's original NPRM.[49] The comments objected to the "vague" nature of the Regulations, particularly as to the lack of a definition of abortion. Further, "By focusing exclusively on the personal moral and religious beliefs of the health care provider, the proposed regulation unconscionably favors one set of interests, upsetting the carefully crafted balance that many states have sought to achieve." One such "balance" is that found in Connecticut, in which a victim of sexual assault is entitled to EC, even if the dispensing physical is conscientiously opposed. According to the comments, "the proposed regulation undermines this balancing of the interests of the patient and health care provider by failing to ensure that the patient's rights are adequately protected." Furthermore, should the Regulations be enforced "[f]or the plaintiff States, Connecticut, Illinois, California, New Jersey, Massachusetts, Rhode Island, Oregon, the loss [of HHS funds] would total billions of dollars annually."

The complaint has six counts: (1) the Regulations violate the Administrative Procedures Act by exceeding Congressional delegation of authority, (2) the Regulations violate the Administrative Procedures Act by failing to respond adequately to "significant public comments," (3) the Regulations violate the Spending Clause due to vagueness, (4) the Regulations violate the Spending Clause due to unrelatedness, (5) the Regulations violate the Spending Clause due to coercion (6) a declaratory relief asking to define the applicability of the Regulations to emergency contraception.

Substantially similar lawsuits were also filed in federal court in Connecticut by the Planned Parenthood Federation of America, as well as the American Civil Liberties Union (on behalf of the National Family Planning & Reproductive Health Association).[50]

Regulations under Barack Obama

On March 10, 2009 HHS issued an NPRM proposing "Rescission of the Regulation entitled 'Ensuring That Department of Health and Human Services Funds Do Not

Support Coercive or Discriminatory Policies or Practices in Violation of Federal Law.'"[51] According to the NPRM,

> The Department of Health and Human Services proposes to rescind the December 19, 2008 final rule entitled "Ensuring That Department of Health and Human Services Funds Do Not Support Coercive or Discriminatory Policies or Practices in Violation of Federal Law." The Department believes it is important to have an opportunity to review this regulation to ensure its consistency with current Administration policy and to reevaluate the necessity for regulations implementing the Church Amendments, Section 245 of the Public Health Service Act, and the Weldon Amendment.[52]

The NPRM explains the legislative framework for conscience protection and then notes, "No statutory provision requires the promulgation of rules to implement the requirements of the Church Amendments, Public Health Service (PHS) Act Sec. 245, and the Weldon Amendment. Nevertheless, on August 26, 2008, the Department exercised its discretion and issued a proposed rule [the Regulations]…"[53] After describing the previous comment period and the non-discrimination framework laid out by the Regulations, the NPRM concludes,

> Commenters asserted that the rule would limit access to patient care and raised concerns that individuals could be denied access to services, with effects felt disproportionately by those in rural areas or otherwise underserved. The Department believes that the comments on the August 2008 proposed rule raised a number of questions that warrant further careful consideration. It is important that the Department have the opportunity to review this regulation to ensure its consistency with current Administration policy.

The NPRM solicited public comment until April 9, 2009. In particular, it solicits comments in four areas. To wit:

> 1. Information, including specific examples where feasible, addressing the scope and nature of the problems giving rise to the need for federal rulemaking and how the current rule would resolve those problems;
>
> 2. Information, including specific examples where feasible, supporting or refuting allegations that the December 19, 2008 final rule reduces access to information and health care services, particularly by low-income women;
>
> 3. Comment on whether the December 19, 2008 final rule provides sufficient clarity to minimize the potential for harm resulting from any ambiguity and confusion that may exist because of the rule; and
>
> 4. Comment on whether the objectives of the December 19, 2008 final rule might also be accomplished through non-regulatory means, such as outreach and education.

As with the Regulations, numerous groups from submitted comments during the period.[54] Over 49,000 comments were submitted in defense of the Regulations, many through the website www.Freedom2Care.org, an umbrella coalition of socially conservative organizations active in the question of conscience protection—such as the American Association of Pro-Life Obstetricians and Gynecologists, the Catholic Medical Association, Med Students for Life, the Catholic Family and Human Rights Institute, Family Research Council, Focus on the Family, and the Alliance Defense Fund, among many others.[55] Founded by the Christian Medical Association, Freedom2Care seeks "to educate and persuade the public, policy makers and the medical community regarding conscience rights in healthcare."[56]

A representative comment in favor of recission was filed by the National Women's Law Center. In it, they state "the HHS Regulation allows providers and entities to ignore the health needs of patients and restrict access to a wide range of health care services, information, counseling, and referrals. It opens the door for insurance plans, hospitals, and other entities to deny women access to most forms of birth control. The HHS Regulation has a disproportionate impact on low-income women and other vulnerable communities." As such, recession is necessary in order to clear the "confusion" caused by the ambiguous language in the Regulations, and to maintain "access" to healthcare services (especially for low-income women). They argue that "non-regulatory means" should suffice to protect the conscience rights of physicians.[57]

The day before the comment period ended, Freedom2Care also facilitated an event at the National Press Club to publicize new polling on conscience protection.[58] The Christian Medical Association and the Polling Company released the results of a poll conducted to gauge the public's position on the question of protection for physicians' conscience.[59] The results were very encouraging to those who support the conscience rights of healthcare professionals: 87% agreed that it is important to "maker sure that healthcare professionals in America are not forced to participate in procedures and practices to which they have moral objections." (65% of respondents said this was "very essential.") Fifty-seven percent opposed regulations "that require medical professionals to perform or provide procedures to which they have moral or ethical objections," whereas only 38% favored such regulations. After hearing an explanation of the Regulations participants were asked if they agreed with them, and 63% responded affirmatively—versus 28% to the contrary. This number includes 56% of those who said they voted for Barack Obama in November 2008, and 60% of those who identify as "pro-choice."[60] When asked if they supported or opposed the proposed rescission, 62% said that they opposed, while only 30% supported.

CONCLUSION

Given the recent NPRM by the Obama Administration to rescind the Regulations, it is likely that the three lawsuits will be dismissed for mootness.

Assuming HHS rescinds Bush's conscience regulations, conscience protection will return to the *status quo ante* Leavitt. The existing legislative protections of conscience (Church, Coats, and Weldon) will remain, although they will lack any effective enforcement mechanism.[61]

Endnotes

1 42 U.S.C. 3001-7.

2 42 U.S.C. 238n (also known as the "Coats Amendment").

3 Consolidated Appropriations Act, 2008, Pub L. 110-161, §508(d), 121 Stat. 1844, 2209 (Note, that being an appropriations "rider," rather than a law, the Weldon Amendment is more vulnerable in a hostile Congress, which can simply remove it during the next round of appropriations).

4 Department of Health and Human Services 45 CFR Part 88, *available at* http://secretarysblog.hhs.gov/my_weblog/2008/08/physician-con-2.html.

5 *Available at* http://prochoicevic.com/files/webfm/pdf/firstBill.pdf.

6 Following a chaotic and contentious comment period on the proposed conscience rules, the Ontario Physicians College was forced to jettison the most anti-conscience components. Nonetheless, physicians with conscientious objections still might be subject to the judgments of the Ontario Human Rights Commission. For a fuller treatment, *see* John Jalsevac, *Ontario Physicians College Backs Away from Controversial Conscience-Restriction Policy*, LifesiteNews.com, Sept. 18, 2008, *available at* http://www.lifesitenews.com/ldn/2008/sep/08091809.html.

7 Federal Register / Vol. 74, No. 45 / Tuesday, March 10, 2009 / Proposed Rules 10207, *available at* http://www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=090000648090229f.

8 *Available at* http://www.acog.org/from_home/publications/ethics/co385.pdf.

9 For a fuller treatment of the ethical problems present in the Opinion see William L. Saunders, *Let Your Conscience Be Your Guide*, Perspective (Family Research Council).

10 American Board of Obstetrics & Gynecology, Bulletin for 2008: Maintenance of Certification; Voluntary Recertification Certificate Renewal, at 10, ¶5.b (Nov. 2007).

11 *Id*. at 31, ¶3.f (Nov. 2007).

12 There is no reason to think the views of the Opinion would not be mainstreamed. However, it is possible that parliamentary action could be taken by the membership of ACOG in opposing the Opinion as happened in Ontario. (*See supra* note 6).

13 Letter to ACOG, signed by 29 representatives of non-governmental advocacy groups, *available at* http://www.cmda.org/AM/Template.cfm?Section=Home&TEMPLATE=/CM/ContentDisplay.cfm&CONTENTID=12243.

14 Secretary Leavitt's letter to ACOG and ABOG, *available at* http://www.hhs.gov/news/press/2008pres/03/20080314a.html.

15 "Physician Conscience," August 7, 2008, *available at* http://secretarysblog.hhs.gov/my_weblog/2008/08/physician-consc.html.

16 Robert Pear, "Abortion Proposal Sets Condition on Aid," *New York Times,* July 15, 2008, *available at* http://www.nytimes.com/2008/07/15/washington/15rule.html?_r=1&scp=2&sq=proposed%20regulations%20birth%20control&st=cse&oref=slogin.

17 *Id.*

18 It is worth noting that the furor caused by the conception definition (in lieu of the "implantation" definition) reflects a larger debate within the medical community. *Pace* the vocal protestations of pro-abortion advocates, the implantation definition is *not* the settled scientific consensus on the beginning of pregnancy. In fact, the conception definition is one that enjoys widespread support in medical textbooks and other authorities within the field. *See* Christopher M. Gacek, *Conceiving 'Pregnancy' U.S. Medical Dictionaries And Their Definitions of "Conception" and "Pregnancy,"* Insight (Family Research Council) (April 2009).

19 NARAL Pro-Choice America, formerly known as the National Abortion and Reproductive Rights Action League, from the National Abortion Rights Action League, in turn formerly known as the National Association for the Repeal of Abortion Laws as founded by Dr. Bernard Nathanson and Betty Friedan in 1968.

20 https://secure.prochoiceamerica.org/site/Advocacy?pagename=homepage&page=UserAction&id=3253&autologin=true&JServSessionIdr012=61loe9ffe1.app44b.

21 http://nchla.org/datasource/idocuments/8HHSsig5.08.pdf.

22 "Physician Conscience Blog II," August 11, 2008, *available at* http://secretarysblog.hhs.gov/my_weblog/2008/08/physician-consc.html.

23 "Physician Conscience Blog III," August 21, 2008, *available at* http://secretarysblog.hhs.gov/my_weblog/2008/08/physician-con-1.html.

24 *Id.*

25 *Id.*

26 As defined in Section 88.2 Definitions: Health Care Entity / Entity: While both PHS Act § 245 and the Weldon Amendment provide examples of specific types of protected individuals and health care organizations, neither statute provides an exhaustive list of such health care entities. PHS Act § 245 defines "health care entity" as "includ[ing] an individual physician, a postgraduate physician training program, and a participant in a program of training in the health professions." As the Department has previously indicated, the definition of "health care entity" in PHS Act § 245 also encompasses institutional entities, such as hospitals and other entities. The Weldon Amendment defines the term "health care entity" as "includ[ing] an individual physician or other health care professional, a hospital, a provider-sponsored organization, a health maintenance organization, a health insurance plan, or any other kind of health care facility, organization, or plan." The Church Amendment does not define the term "entity," and does not use the term "health care entity." In keeping with the definitions in PHS Act § 245 and the Weldon Amendment, the Department proposes to define "health care entity" to include the specifically mentioned organizations from the two statutes, as well as other types of entities referenced in the Church Amendments. It is important to note that the Department does not intend for this to be a comprehensive list of relevant organizations for purposes of the regulation, but merely a list of examples.

27 Section 88.1 "Purpose."

28 Section 88.2 "Definitions."

29 Some "entities" covered are physicians, hospitals, medical training programs. *See* fn. 26 above for a complete list.

30 *See supra* note 16.

31 88.4(a)(1).

32 88.4(a)(2).

33 88.4(a)(3).

34 The affected institutions are identified in §88.3 "Applicability."

35 Section 88.5 "Applicability" State and local governments, private entities, teaching hospitals, and government funded research institutions are all affected by these regulations in ways laid-out in this section.

36 The Regulations threaten withholding of HHS funds for non-compliant recipients, while requiring that recipients certify that they understand their obligations and are complying with them. Furthermore, alleged discrimination on the grounds of conscience is referred to HHS's Office of Civil Rights for investigation.

37 http://www.nfprha.org/images/HHS_Regs.pdf.

38 http://www.ippf.org/NR/rdonlyres/6649ED84-2EA1-4C88-8A86-CA19BBB19463/0/AbortionLawToolkit.pdf.

39 CEDAW Committee, 37th Sess. (2007), "Report on Poland," ¶ 25.

40 CEDAW Committee, 42nd Sess. (2008), "Report on Portugal," ¶¶ 42-43.

41 Report of the United Nations Committee on the Elimination of Discrimination Against Women, 17th Sess., to the General Assembly of the United Nations, 52nd Sess. (1997), "Report on Italy," Document #A/52/38/Rev. 1, ¶ 353 and ¶ 360.

42 CEDAW Committee, Combined second, third and fourth periodic report of Slovakia(2008), CEDAW/C/SVK/4.

43 *Available at* http://www.plannedparenthood.org/files/AMA_et__al__Comments.pdf

44 http://www.azag.gov/press_releases/sept/2008/provider%20conscience%20regulation.pdf.

45 http://www.guttmacher.org/media/resources/2008/09/24/Guttmacher-Institute-re-ConscienceRegulation.pdf.

46 *Conn. Attorney General Blumenthal Plans To Challenge HHS 'Conscience'*

Rule, Medical News Today, Dec. 23, 2008, http://www.medicalnewstoday.com/articles/133983.php.

47 Public Act 07-24, Conn. Gen. Stat. § 19a-112e.

48 http://www.ct.gov/ag/cwp/view.asp?A=2341&Q=432008.

49 *See supra* note 43.

50 http://www.aclu.org/reproductiverights/gen/38342prs20090115.html.

51 Federal Register / Vol. 74, No. 45 / Mar. 10, 2009 / Proposed Rules 10207, available at http://www.regulations.gov/fdmspublic/component/main?main=DocumentDetail&o=090000648090229f.

52 *Id.*, "Summary."

53 *Id.* at 10207, "Rulemaking."

54 For comments in favor the recession, see the comments by the American Medical Association et al. http://www.texmed.org/uploadedFiles/Public_Health_And_Science/Alerts_And_Updates/Conscience%20rule%20letter.pdf.

55 http://www.freedom2care.org/about/page/participating-organizations.

56 http://www.freedom2care.org/about/.

57 http://www.nwlc.org/pdf/nwlc%20rescission%20comments%20final.pdf.

58 http://washingtontimes.com/news/2009/apr/19/duin-pro-life-doctors-face-consequences/.

59 "Key Findings on Conscience Rights Polling," Apr. 8, 2009 *available at* http://www.freedom2care.org/docLib/20090407_090408SurveyPressPacket.pdf.

60 It should be noted that the summary of the Regulations only speaks to the performance of abortion and not the referral for abortion as well. It is possible that this skewed the results in favor of the Regulations. The text of the description is as follows: "Just two months ago, a federal law known as 'conscience protection' went into effect after reports of doctors being discriminated against for declining to perform abortions. It protects doctors and other medical professionals who work at institutions that receive federal money from performing medical procedures to which they object on moral or religious grounds."

61 It is also possible that the Weldon amendment will be eliminated during negotiations over appropriations. *See supra* note 3.

The American Recovery and Reinvestment Act and Faith-based Organizations

*By Stanley Carlson-Thies**

The American Recovery and Reinvestment Act[1] (ARRA or "stimulus plan") allocates nearly 800 billion federal dollars for federal, state, and local government expenditures. As usual in the American "third-party government"[2] system, much of the money for products and services will not be spent directly by government agencies but instead will be awarded to private organizations. It will be these entities that expend the federal funds for many of the purposes specified in the law: construction companies that contract to complete some "shovel-ready" project, private businesses that receive federal dollars to fund a "green" product, and nonprofit organizations that win grants to carry out one or another of the social service and education programs that ARRA funds. Among those nonprofit organizations will be many faith-based organizations.

In what ways can faith-based organizations obtain ARRA funds? That is, are they eligible to apply for the funds, and if so, what church-state "strings" are attached to those dollars? The Act includes some specific language about religion and faith-based organizations. But most of the rules that apply to faith-based participation in stimulus spending are implicit, or rather specified outside of ARRA, in the standards associated with the Faith-Based and Community Initiative—rules first formulated during the Clinton administration and extended during the Bush administration.

ARRA to be Pro-Poor and to Utilize Faith-Based Organizations

That the stimulus plan is intended not only to promote economic "recovery" but also to change society and the economy through a range of "reinvestments" has been controversial. Less remarked upon have been two additional goals of the spending plan: "to alleviate the poverty made worse by economic crisis"[3] and to do so specifically by engaging grassroots organizations, both secular and faith-based.

Faith-based organizations, on the other hand, have given these latter aspects close attention.[4] Catholic Charities USA, which worked in the Senate to fend off cuts to social-service funds authorized in the House-passed stimulus bill, celebrated ARRA as "an economic recovery package that assists and protects the least among us,"[5] and provides various tools on its website to help nonprofit organizations identify grant opportunities and track ARRA spending.[6] Similarly, "lawmakers in heavily black districts," according to one report, "are already expressing hope about the [stimulus plan's] boost to religious-based organizations."[7]

Indeed, the twin goals of fighting poverty and engaging grassroots organizations via ARRA expenditures are key concerns of the Obama faith-based initiative. The press release announcing the President's Office of Faith-Based and Neighborhood Partnerships emphasized that its "top priority will be making community groups an integral part of our economic recovery and poverty a burden fewer have to bear when recovery is complete."[8] Similarly, one of the task forces of the new Advisory Council on Faith-Based and Neighborhood Partnerships will focus on "the role of community organizations in economic recovery."[9]

In assessing ARRA expenditures, then, the Obama administration intends to consider not only whether funds are spent "as quickly as possible consistent with prudent management," as specified in the Act,[10] but also whether the funds intended for social purposes flow out to needy neighborhoods and grassroots organizations and are not diverted or retained by state and local agencies for other purposes. To monitor the expenditures the Administration is counting not only on extensive reporting requirements and such "transparency" tools as the Recovery.gov website, but also on its connections to grassroots religious and secular organizations through its faith-based Office and Advisory Council. As Melody Barnes, director of the Domestic Policy Council, has said, President Obama wants "one of the functions" of his faith-based office to be "implementation of the Recovery Act," and one way the office will be useful is by "being the connection between the bill and the reality."[11]

Given all that can happen to federal intentions and funds in the long journey between Washington, D.C., and the place and agency where the money finally ends up, such a monitoring role can be seen as administratively wise.[12] In any case, it surely is a sign of the Administration's seriousness about extensively engaging with faith-based and community-based organizations through its revised faith-based initiative.

Specific FBO Provisions

Most of the ARRA language specifically related to religious organizations concerns educational institutions. Ironically, those provisions are hardly uniformly welcoming of their participation.

Bias against Private and Religious Education. ARRA allocates $53.6 billion to a State Fiscal Stabilization Fund (SFSF). Some of these funds can be used to repair and upgrade public schools, including bringing them up to "green" standards, but not, despite efforts to eliminate the restriction, to aid private and religious schools.[13] Similarly, SFSF funds will be used to restore education funding that has been cut due to states' budget crises, but these compensatory funds can go only to public school districts and to public higher education.[14] The limitation is expected and understandable, and yet, as advocates of private schooling have pointed out, expenditures on private school facilities are just as stimulative as spending on public school buildings.[15]

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Restrictions on Religious Higher Education. A small portion of the SFSF funds can be used for the "modernization, renovation, or repair" of higher education facilities—including those at private and faith-based colleges and universities. However, these funds cannot be expended on facilities "used for sectarian instruction or religious worship," or where "a substantial portion of the functions of the facilities are subsumed in a religious mission."[16] Federal higher education construction funds have long been excluded from use on structures with a specifically religious use, such as chapels. However, the ARRA restrictive language seems overly broad (for example, it could say expenditures are not permitted on facilities "used *primarily* for sectarian instruction or religious worship," but does not) and thus could be interpreted to exclude certain religious higher education facilities or, in the future, to ban student religious clubs from buildings renovated with SFSF funds.[17] An amendment by Senator DeMint (R-SC) to jettison the restriction failed.[18]

A Puzzling Impediment to Private and Religious Schools. ARRA allocates some $25 billion extra dollars to federal programs for disadvantaged and special needs students by greatly increasing the funding of special services authorized in the Elementary and Secondary Education Act (ESEA) and the Individuals with Disabilities Education Act (IDEA). These statutes have an equitable expenditure requirement that ensures that local school districts receiving the federal funds support special needs students, whether they attend public schools or private or faith-based schools.[19]

However, ARRA also allocates additional billions of dollars for special services without including the equitable expenditure mandate. Many of the billions of dollars of SFSF money that is flowing to public school districts must be spent on the special services authorized by ESEA and IDEA, and other special services authorized by the Adult Education and Family Literacy Act and the Perkins Act. All of these programs permit or require participation by private entities, including faith-based schools. However, the ARRA language is written such that there is no requirement that this additional money adhere to an equal opportunity or equitable participation standard.[20]

Inclusive and Restrictive Early Childhood Programs. ARRA allocates extra funding for child care. The federal child care program was crafted in 1990 to encourage states to extensively use vouchers, rather than only to contract with providers. Because of the vouchers—a form of "indirect" government funding of private organizations—parents are able to select the provider of their own choice, including faith-based providers whose programs include religious activities.[21]

Extra funding is also allocated to Head Start, which utilizes many nonprofit organizations. But the Head Start statute prohibits hiring on the basis of religion by its grantees, thus excluding those faith-based organizations that regard religious staffing to be an essential way to maintain their organizations' mission focus.[22] An effort in the 110th Congress to eliminate this restriction failed.[23] ARRA leaves the barrier intact.[24]

Welfare and Social Spending. ARRA allocates additional funds to both the federal welfare program (Temporary Assistance for Needy Families, TANF) and the Community Services Block Grant (CSBG) program. These sections of ARRA say nothing about faith-based organizations. However, what governs is language about faith-based organizations in the statutes for those programs: during the Clinton administration, Congress adopted and President Clinton signed into law Charitable Choice provisions for these two block grant programs—language directing state governments to allow faith-based organizations to compete in the provision of services without being excluded because of their religious character.[25]

A New Version of the Compassion Capital Fund. The stimulus plan includes one other arrangement specifically related to faith-based organizations. The Bush administration annually requested and received appropriations for a Compassion Capital Fund (CCF) that awarded grants to private intermediary organizations to provide capacity-building technical assistance to grassroots groups, both faith-based and secular, and minigrants to some of these groups for the purchase of equipment or additional training.[26] Church-state separationist groups challenged CCF assistance given to faith-based organizations[27] and they protested the proposed extension of CCF via the stimulus plan.[28] Indeed, AARA did not continue CCF. However, it created in its place a new program, not named in the Act, to expand the capacity of nonprofit organizations that serve "individuals and communities affected by the economic downturn."[29] Nothing in the ARRA language or in the section of the Social Security Act which governs these expenditures restricts participation by faith-based organizations—or even provides guidance about their participation.

Federal Guidelines for Faith-Based Involvement

ARRA allocates additional billions of federal dollars for other social service programs in which the services can be provided by private organizations, such as Senior Nutritional Services, the Emergency Shelter Grant program, the Energy Efficiency and Conservation Block Grant program, and the Violence Against Women program.[30] The Act itself does not specify the conditions under which faith-based organizations might receive these billions of dollars nor even whether they are eligible at all, so we must look elsewhere for that answer.

Of course, these two questions—the eligibility of faith-based organizations for government funding, and the terms of their participation—have been central issues for the federal faith-based initiative. Advocates of the initiative have spoken of desiring greater involvement by faith-based organizations because of their proximity to people in need or because of the moral and spiritual values these organizations exemplify. Jay Hein, the director of the White House Office of Faith-Based and Community Initiatives in the latter years of the Bush administration, often spoke of reorienting the federal government to become a support for bottom-up solutions to social problems. Whatever these large aims, a key focus throughout has been to assess and improve the rules that govern federal financial partnerships with faith-based organizations. The principle reform, tracking the development of the Supreme Court's Religion Clause jurisprudence that culminated in *Mitchell* v. *Helms* (2000),[31] has been to shift federal policy and practice from excluding "pervasively sectarian" organizations from funding to requiring "equal opportunity" or "equal

treatment"—no bias against (or for) faith-based organizations—while requiring that funds provided "directly" to a religious organization may not be used to pay for "inherently religious activities."[32]

Charitable Choice. The first major instance of this change of policy was the incorporation of the Charitable Choice principles into federal law during the Clinton administration—into the TANF program in 1996, Welfare-to-Work in 1997, the CSBG program in 1998, and the substance-abuse prevention and treatment programs of the Substance Abuse and Mental Health Services Administration (SAMHSA) in 2000.

The Charitable Choice provisions, which are all similar but not identical, specify that faith-based organizations are eligible to seek government funds on the same basis as their secular counterparts, without being barred because they are religious; protect their religious character (e.g., display of religious symbols; conduct of privately funded, voluntary, religious activities; clergy on the governing board; a religious mission) notwithstanding the receipt of federal funds; prohibit the expenditure of government funds for "inherently religious activities" such as "sectarian worship, instruction, or proselytization"; and require that all eligible beneficiaries be served, without discrimination on religious grounds. Additionally, under Charitable Choice, government officials are generally required to ensure that an alternative is available for beneficiaries who object to receiving services from a faith-based organizations, and most versions of Charitable Choice specifically state that the Title VII freedom of religious organizations to make employment decisions on a religious basis is preserved notwithstanding the receipt of federal funds.[33]

The Bush administration, responding to evidence that state and local governments had not uniformly aligned their funding policies with the Charitable Choice provisions in these federal block-grant programs, adopted Charitable Choice regulations in 2003 to provide specific guidance.[34] The Administration also undertook a variety of informational and technical assistance steps to promote understanding of and compliance with Charitable Choice by state and local officials, such as the publication of a handbook, *Partnering with Faith-Based and Community Organizations: A Guide for State and Local Officials Administering Federal Block and Formula Grant Funds*.[35]

Equal Treatment Regulations. As noted, Charitable Choice only applies to a few federal social-service programs. To ensure that federal expenditures in the other programs would follow the same constitutional principles, President Bush promulgated an executive order in 2002 setting out guidelines similar to Charitable Choice.[36] The main difference with Charitable Choice is that no right to an alternative service provider was created in these other programs and, because among the federal programs the executive order covers are some that prohibit religious employment discrimination, there could not be a general statement that faith-based organizations would retain their freedom to consider religion in hiring and firing when receiving federal funds.[37]

During the course of 2004, the Bush administration proposed and then adopted Equal Treatment regulations for many federal departments to guide the expenditure of their funds, whether by federal, state, and local government officials, in programs that utilize private social-service providers. The Department of Health and Human Services regulations, for example, are entitled, "Participation in Department of Health and Human Services Programs by Religious Organizations; Providing for Equal Treatment of All Department of Health and Human Services Participants," and apply both to discretionary grants and to block and formula grants awarded to state or local governments.[38]

Non-Profit Status. In a reform important especially to smaller faith-based organizations, the Bush administration took note of the expense and time required for organizations to obtain IRS 501(c)(3) designation. Several federal programs had limited applicants to only those with 501(c)(3) status, but the Bush administration declared that such status should be an eligibility condition only when specifically required by a program's governing statute. Typically those statutes say only that applicants must be "nonprofit organizations." In regulations such as the SAMHSA Charitable Choice rules, the Administration listed several ways that an organization could prove its nonprofit character without needing the IRS designation.[39]

Staffing on a Religious Basis. The Bush administration clarified one other important and controversial matter: the freedom of faith-based organizations to consider religion in their employment decisions notwithstanding the receipt of federal funds. When Congress, more than forty years ago, established in the Civil Rights Act of 1964 federal employment non-discrimination standards, it included an exemption so that faith-based organizations can make employment decisions on the basis of religion, even though other employers are prohibited from doing so. Although there seems to have been a presumption by many officials, legislators, and activists to the contrary, there is no requirement in the 1964 Civil Rights Act that a religious organization that receives government funds thereby must give up its Title VII exemption that permits it to hire and fire by religious criteria.[40] However, the religious staffing freedom is lost if a faith-based organization receives funds from a program that includes a ban on religious (and other) employment discrimination. Some federal programs, such as the Head Start program, as noted above, do have a provision that prohibits religious hiring by funding recipients. On the other hand, most versions of Charitable Choice explicitly preserve the Title VII religious exemption for participating faith-based organizations. And the laws governing most federal social-service programs have no employment provisions at all, thus leaving intact the religious exemption. The Bush administration laid out these facts and this argument in a document it issued in 2003,[41] and it worked to ensure that federal practice followed this understanding. The Office of Legal Counsel in the Department of Justice further issued a ruling that under the Religious Freedom Restoration Act, in programs that ban religious staffing, a faith-based organization that can show that adhering to the ban would impose a substantial burden on its religious practice can be excused from complying with the ban.[42]

Standards for Faith-Based Organizations in Summary. These church-state standards for religious organizations interested in collaborating with federal programs and receiving federal funds can be summarized in these points:

- Faith-based organizations, whether "pervasively sectarian" or religiously affiliated, are eligible to participate in federally funded programs on the same basis as their secular counterparts, being neither favored nor disfavored because of their religious character;
- The faith-based organizations may retain their religious character despite receiving government funds: they may have a religious name and religious language in their mission statement, they may display religious symbols, they may select their governing board on a religious basis;
- They may continue to offer voluntary, privately funded, religious activities;
- In the federally funded program all eligible beneficiaries must be served without religious discrimination;
- If the federal funding is "direct," then "inherently religious activities" must be kept separate in time or location from the federally funded program (if the funding is "indirect"—e.g., by means of vouchers—then religious activities can be mixed into the federally funded services);
- The faith-based organization retains its exemption that permits religious staffing, unless the program statute forbids religious employment discrimination;
- State and local government agencies that receive the federal funds and then award it to private providers are bound to the Equal Treatment or Charitable Choice rules when they expend the federal funds, required matching state or local funds, and state or local funds that are voluntarily commingled with the federal funds.

These standards apply to social service funding distributed by ten Federal agencies—the Departments of Agriculture, Commerce, Education, Health and Human Services, Housing and Urban Development, Labor, Justice, and Veterans Affairs, the Agency for International Development, and the Small Business Administration[43]—absent new statutory language to the contrary or superseding regulations.

Federal Guidelines and the Obama Administration

As a presidential candidate, Barack Obama said he would revise the Bush faith-based initiative by stressing more strongly the dividing line between church and state and by banning religious staffing in every social-service program that a faith-based organization funds with federal dollars. However, when he announced his Office of Faith-Based and Neighborhood Partnerships and an accompanying Advisory Council as President, these changes were downplayed. The current standards, including those on religious hiring, are to remain in place, subject to legal review.[44]

Interestingly, ARRA's creation of a new version of the Bush Compassion Capital Fund has required to the Administration to state explicitly how it understands the church-state rules that must apply to faith-based recipients of federal funds. In mid-May, the Department of Health and Human Services announced the creation of the new Strengthening Communities Fund (SCF).[45] One component of SCF will award grants to mature nonprofit organizations to provide capacity-building services to grassroots groups working in distressed communities to encourage economic recovery; the other component will fund a number of state, county, city, and tribal offices that reach out to faith-based and community-based groups to pay for capacity-building help to grassroots groups and to help the offices improve their own ability to assist those grassroots organizations. Unlike the other federal programs, this is not a grant program that was already designed and operating when the new administration took over.

What, then, are the Obama administration's church-state standards for SCF? They are the standards promulgated by the Bush administration in the HHS Equal Treatment regulations.[46] No new religious staffing ban is imposed. Faith-based organizations do retain their religious character and private religious practices. Officials and grantees cannot discriminate either for or against individuals or applicant organizations on the basis of religion. The direct federal funds cannot be used to support "inherently religious activities."

In short, the unspoken rules that govern the receipt of ARRA money by faith-based organizations remain the rules developed during the Clinton and Bush administrations.

Subsidiarity

A final word on faith-based organizations and the stimulus plan. Among the richest bodies of thought on relations between church and state, and between civil society and government, is the Catholic social doctrine of "subsidiarity" and the lesser-known but similar neo-Calvinist concept of "sphere sovereignty."[47] Both of these religiously inspired socio-political frameworks stress that for collaboration between faith-based organizations and government to flourish, the relationship must be a true partnership. A partnership requires that the government respect the unique—*the distinct*—character of religious civil-society institutions, instead of requiring them to fit into a secular mold or to downplay their own initiative and to mimic the government's way of operating. The faith-based initiative, now in its third phase or third version, can be interpreted, among other things, as an intensive effort to redesign the federal relationship with faith-based organizations to match this partnership ideal.[48]

Both frameworks also carry another message, however: the government must leave adequate social space, adequate opportunity, for private organizations to exercise their own responsibilities. A flourishing society will not be achieved if the government takes responsibility for all social endeavors, but makes sure that it respectfully partners with private groups to carry out all those tasks. Rather, simply by occupying all of that space the government already has undermined the civil society organizations, because it has robbed them of a full opportunity to define their own sense of what should be done and how to do it, and eliminated their chance to seek voluntary support that allows them to be independent of government.

The American Recovery and Revitalization Act, for all the hundreds of billions in new federal spending—and

notwithstanding its impact widely in the economy, society, education, and health care—comes nowhere near causing government to smother civil society. Still, the very scope of this intervention and its spending has created a useful occasion to think carefully not only of the appropriate relationship between government and faith-based service providers but more broadly about which entities in society can best accomplish which purposes.

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grants, contracts, and cooperative agreements for private organizations to provide services to needy individuals, families, or communities. Many critics of the Bush policy on religious hiring have mistakenly supposed that by means of this executive order President Bush unilaterally created a right for faith-based organizations to engage in "federally funded job discrimination." To the contrary, aside from the modification of the executive order relating to contracting (a provision created by a President and therefore subject to modification by a President), the hiring protections the Bush Administration embraced were those endorsed by Congress (e.g., faith-based organizations who accept federal funds do not automatically lose the hiring protections recognized by Congress in Title VII) and the courts (e.g., the Supreme Court has abandoned the "pervasively sectarian" standard, under which religious hiring practices had been one of the factors that might show a faith-based organization to be "too sectarian" to receive federal funds).

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Telecommunications & Electronic Media

Government-Run Broadband: Will it Work this Time?

*By Ray Gifford & Mark Walker**

In "The Music Man," Professor Harold Hill convinced the people of River City, Iowa that forming a band would protect the town's boys from sin and corruption. In a modern replay, today's music men are trying to convince cities that government-run broadband networks will bring economic, cultural, and educational benefits. Though it is not quite saving the youth from the iniquities of pool-playing, the government-run broadband promise is an equally hollow con. To date, government-run broadband has a consistent track record of over-promising and under-delivering. But $4.7 billion of stimulus under the Broadband Technology Opportunities Program (BTOP) and $4.2 billion for potential broadband-related 'smart grid' technologies is breathing new life into the government-run broadband movement.

To be sure, debates over municipal broadband have devolved and "become so polarized that it has led to an oversimplification of the government-sponsored choices."[1] Often the proponents and opponents of municipal broadband "have acted as if there are only two options—leave the private sector investment to unfold on its own or alternatively intervene to offer a ubiquitous government-sponsored network."[2] That said, the financial record of municipal network operators is overwhelmingly poor, caused primarily by unrealistic business plans, including the inability of municipal operators to achieve the necessary scale to compete with larger network operators. In turn, the subsidies necessary for government-run broadband leads to higher taxes, jeopardizes bond ratings, and increases the cost of other municipal services. It may also have the unintended consequence of entrenching inferior communications technologies because government lacks the ability to continuously upgrade its plant and facilities, as private providers do in response to competitive pressure.

The poor financial record of municipal broadband deployments is well documented.[3] This is particularly true where a municipal operator seeks to enter a competitive communications market with large well-established service providers. The primary cause of a municipal operator's poor financial performance is the lack of scale enjoyed by the much larger network operators in the market. Simply put, larger network operators can more efficiently spread the costs of infrastructure and back office operations across a substantially larger customer base.

Three themes have emerged based on the poor financial performance of municipal networks in competitive markets. First, the business plans of municipal networks routinely underestimate and misunderstand the competitive and dynamic marketplace for communications services, resulting in substantial overestimates of revenue. Second, beyond the initial construction costs, the business plans of municipal operators do not adequately account for the substantial ongoing costs associated with owning and operating a broadband network. Third, to maintain the offered communications services as losses grow, municipalities are forced to subsidize those services, leading to higher than necessary taxes and/or increased fees for other municipal services and the potential unintended consequence of entrenching inferior technologies.

In other words, the business plans for municipal networks have historically relied on unrealistic assumptions by overestimating revenues while at the same time underestimating capital and operating expenses. In turn, the municipality must cover budget shortfalls through higher taxes and/or increased rates for other municipal services.

Many local governments providing municipal broadband networks have failed to understand or comprehend the competitive and dynamic nature of the communications market, leading to over estimated revenues and other unrealistic business assumptions. The financial performance of networks Provo (UT), Cedar Falls (IA), Lebanon (OH), and Ashland (OR) stand as cautionary tales for government-run broadband enthisiasts:

The Case of iProvo

iProvo's well-documented financial troubles occurred, in large part, because of its inability to achieve its underlying business assumptions in the face of a fiercely competitive market. In 2006, the City of Provo, with a population of approximately 117,000, completed construction of a fiber-to-the-home network, iProvo.[4] From its initial service launch, iProvo faced strong competition from Qwest and Comcast, two well established service providers that were unwilling to cede customers to the municipal upstart.[5]

iProvo relied on an overly optimistic prediction of customer acquisition and revenue per customer. "As of December 2007, iProvo reported 10,265 customers, the target it had set for December 2005. Furthermore, the iProvo plan had projected that 10,000 customers would be the break even point. That turned out not to be the case."[6] iProvo's inability to break even with 10,000 customers was due, in part, to an overestimation of revenue per customer. The iProvo business plan assumed 75% of subscribers would sign up for the "triple play" of telephone, Internet, and cable-television services, but as of October 2007, only 17% of customers signed up for the triple play, leading to a substantial overestimate of revenue per customer.[7] Such a gross overestimate completely undermined the iProvo business plan and highlights the City of Provo's sophomoric understanding of the competitive communications market. Even if the underlying assumptions were well founded at the time the business plan was developed, the reality proved to be much different than the proffered business plan, illustrating not only the competitive nature, but more importantly the dynamic nature of the communications market.

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Beyond just competing head-to-head with Qwest and Comcast, iProvo had to compete with emerging substitute service providers as well, further illustrating the dynamic nature of the communications market. For instance, wireless service had become a substitute for wired telephone service and is becoming a substitute for wired-broadband service. In addition, DBS service providers such as DirectTV and Dish Network are a competitive substitute for the cable-television service offered by iProvo. Provo's business plan, overly optimistic in light of the competitive and dynamic communications market, explains at least in part its eventual demise and sale.[8]

Other Municipal Experiences

The example of iProvo does not stand alone as a municipal provider with substantial penetration rates but poor financial performance. "There is evidence that municipal cable and Internet services can achieve high penetration rates if they're willing to lose a lot of money doing it. And this means taxpayer or ratepayer money."[9] As of 2004, the municipal network operated by the City of Cedar Falls, Iowa, had video penetration of 47% and high-speed data penetration of 37%, but from the start of construction in 1995 through 2004 the municipal network had a cumulative free cash flow of *negative* $10,543,588.[10] In Lebanon, Ohio, the municipal provider "achieved a penetration rate of 37 percent in its first year, despite competition from Time Warner. However, it has always shown substantial operating losses... , which suggests the high penetration rate flows from below-cost pricing."[11] Similarly, in Ashland, Oregon, the municipal provider "had a 35 percent penetration rate for cable TV and a 40 percent penetration rate for Internet service as of December 2004. However, the system has posted an operating loss of about $1.5 million each year since 2002."[12] A number of conclusions might be drawn from the overwhelming evidence of poor financial performance in light of the significant market penetration. No matter the exact conclusion, the repeated poor financial performance of municipal providers should give pause before other cities embark on this same path.

Underestimating Ongoing Costs

In addition to overestimating revenues, municipal providers have also regularly compounded their financial challenges by underestimating the ongoing operating, maintenance, and upgrade costs associated with a broadband network. Most importantly, municipalities fail to fully comprehend the economies of scale and the associated cost advantages enjoyed by the much larger network operators. In addition, municipal providers underestimate substantial ongoing costs associated with effectively competing in the communications market. This is due in part to misleading experiences in providing monopoly services such as water, sewer, and electricity. For those services, no competition exists and the pace of technological change is all but imperceptible. By contrast, broadband networks require constant investment and upgrading.

Even assuming a municipal operator accounts for and accurately estimates its expenses, it sits at a relative disadvantage to larger network operators because of the municipal operator's inherent lack of scale. This is evident in terms of comparable costs for back office operations and when purchasing network equipment, such as set-top boxes. Moreover, the municipal operator is "unlikely to achieve enough scale to peer with other networks [and] realize... critical cost savings" in terms of interconnection and backhaul.[13] Similarly, in terms of video service, "the aggregate size of a municipality's subscriber base does not warrant volume discount pricing on content" as enjoyed by larger video service providers such as Comcast, Verizon, AT&T, DirecTV, and Dish Network.[14]

Furthermore, a municipal communications provider often underestimates the cost of customer acquisition and retention. In the monopoly utility context that municipalities know and are used to, customer acquisition and retention costs are negligible.[15] In general, broadband service providers can expect a churn rate of between 2.5% and 3% per month. Over a given year, a provider can expect to lose a quarter of its customers.[16] For instance, iProvo had not fully anticipated the high level of customer "churn" it experienced. "[W]hile iProvo [was] adding an average of 260 customers per month, that gain [was] offset by an average of 140 customers per month" who ended service.[17] "At a cost of $800 to acquire and connect one new customer," this level of churn increased operating expenses well beyond what had been anticipated.[18] In short, a municipal operator must plan for substantial customer acquisition and retention costs where competitive alternatives exist.

Moreover, in a competitive communications market, all service providers, municipal and investor-owned, must continually spend to upgrade their networks to provide a competitive service offering to maintain both market penetration and revenue per customer. Price compression is a natural dynamic with respect to communications services, due to rapid innovation and commoditized services:

> [I]t should be recognized that the pace of competition is increasing and rates for data services have been falling about 20% annually, making it likely that pricing could decline more steeply than modeled. Further, the pricing for telephony appears poised to contract precipitously with the introduction of VoIP services, as average monthly revenue per line could slide from $50, with the downward pressure applied by VoIP rates of $35, $30, or even as low at $15. Many municipal models do not include price compression, as the architects of those models appear to be using regulated rate-of-return pricing or naturally occurring inflation adjustments to price.[19]

Without continually spending on network upgrades and improvements to counteract price compression, a service provider must expect revenues per customer to continually decline.

Cross-Subsidies and Distortionary Effects

To overcome revenue shortfalls and expanding costs, local governments often turn to subsidizing their service offering with tax revenues or revenues from other municipal services, resulting in residents paying higher than necessary taxes and/or prices for electric and other municipal services. In addition to wasting taxpayer money, subsidizing municipal

communications services runs the real risk of entrenching inferior technologies and distorting the incentives of a normal competitive market.

For example, the Internet, telephone, and cable-television services provided over Bristol, Virginia's municipal broadband network, OptiNet, were provided below cost and subsidized by the City of Bristol through either higher fees for other municipal services or higher taxes, or a combination thereof, as determined by the Virginia State Corporation Commission.[20] Similar cross-subsidies have been documented in numerous localities where municipalities provide communication services, including Lebanon, Ohio and Provo, Utah. In Lebanon, "[t]he monthly subsidization in 2004 appears to have been $37 per household, even without factoring capital costs or other cross-subsidizations (use of personnel or other assets)."[21] In Provo, "iProvo asked the City Council to approve the transfer of $1 million from the city's electricity reserve fund to cover the municipal network costs for fiscal 2006."[22] "In addition, a government broadband enterprise could receive an implicit subsidy in the form of costless, below cost, or perhaps even exclusive access to the public rights-of-way."[23]

The municipal services targeted for rate increases to subsidize municipal broadband, typically and logically, are those in which the local government is the monopoly provider, including electric, water, and sewer services. Most local governments that seek to provide communications services, including Bristol, Provo, and Lebanon, already provide electric service to their respective communities.[24] While this provides a place to defray and 'hide' the fixed cost of broadband provision, it is inequitable to electric ratepayers and invites backlash from competitive providers for unfair practices.

The unintended and perverse consequence of subsidizing municipal communications services leads to the real potential for the municipality to entrench inferior technologies by distoring the normal incentives of a competitive market. Consider the following:

> If subsidies allow a government enterprise to offer broadband service at a price that fails to cover costs, then competitors face a higher bar to successful market entry, even if they have a better technology. Suppose, for example, the government offers 200 kilobyte Internet access for $10 per month, even though it costs $20 per month to produce. Suppose further that private competitors could offer 10 megabyte service for $40 per month. Many consumers might prefer the faster service at $40 to the slower service at $20, but they'll choose the slower service if it only costs $10. If the government service is subsidized, the competitor cannot afford to introduce its faster service until further technological progress either improves the quality or reduces the cost sufficiently to let it attract consumers away from the subsidized service. Until that happens, consumers have to content themselves with the slower, subsidized service.
>
> The point here is not just that lock-in via subsidies wastes the public's money, but also that consumers have to wait longer to get a better service, because competitors are deterred by the subsidy. Consumers would be better off if the price of the government service were not subsidized, because competitors would provide the superior combination of service and price sooner.[25]

Finally, government operation and ownership of a broadband network also raises free speech and privacy concerns for its customers. Politically strong interests within a city, including parent and religious groups, may seek to exert pressure on city officials to block or filter objectionable content. For instance, these groups may not find it appropriate to subsidize Internet pornography with their tax dollars. These concerns may be justifiable in terms of indecent, obscene, or other inappropriate content. Local governments, however, should be concerned about potential liability if it incorporates "restrictive use policies or Internet filters that prohibit the receipt or transmission of constitutionally protected material."[26] "As a general principle, the First Amendment bars the government from dictating what we see or read or speak or hear."[27] Even where the intent is to block only unprotected material such as child pornography, the filters and blocking technologies are inherently over-inclusive, preventing access to constitutionally protected material and therefore violating the First Amendment.[28] "The Government may not suppress lawful speech as the means to suppress unlawful speech.... '[T]he possible harm to society in permitting some unprotected speech to go unpunished is outweighed by the possibility that protected speech of others may be muted.'"[29] Understanding the legal risks of filtering technologies, some municipal service providers have even asked their customers to waive their First Amendment claims to avoid potential liability for blocking constitutionally protected content.[30] These waivers of liability are not likely to stand up in court.

Beyond free speech considerations, a municipal broadband network also invokes substantial privacy concerns. "People who have committed no wrong should be able to participate online without fear that someone who wishes to harass or embarrass them can file a frivolous lawsuit and thereby gain the power of the court's order to discover their identity."[31] As an operator of a broadband network, the municipality will collect substantial information regarding its users and their online activities. This point cannot be overstated—a broadband provider has access to every aspect of a subscriber's online experience from online banking to online research relating to "sensitive and very private issues such as health concerns or political activity…."[32] Local governments thus need to have necessary policies and procedures in place and be prepared to litigate to avoid disclosing user information if the request is legally inadequate, irrespective of whether the request is being made by another agency such as law enforcement or a third-party. Moreover, the city should afford the user notice, unless prohibited by court order, before disclosing to another city agency or a third party, allowing the customer to fight the release of his or her personal information.[33]

Municipal entry, in a competitive communications market, creates conflicts of interest, shifts financial risk from investors to taxpayers, and jeopardizes critical public policy goals, including long-term innovation, free speech, and privacy.[34] Broadband is crucial to the economic, educational, cultural, and social structure of the nation's communities. There are many more successful—and less expensive and risky—steps that local governments can take to promote broadband adoption, other than providing retail broadband.

Endnotes

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31 Columbia Ins. Co. v. Seescandy.com, 185 F.R.D. 573, 578 (N.D. Cal. 1999).

32 American Civil Liberties Union of Northern California, Electronic Frontier Foundation, & Electronic Privacy Information Center West Coast Office, *Joint Letter on San Francisco Wireless Internet Access*, Oct. 19, 2005, http://epic.org/privacy/internet/sfws10.19.05.html.

33 *See*, *e.g.*, *id.* (discussing free speech and privacy concerns relating to San Francisco's municipal wireless network and specifically stating that "when a government entity establishes and assumes responsibility for a system that provides public electronic communications services, that constitutes 'state action' for constitutional purposes and requires the City to comply with the dictates of the state and U.S. Constitutions, including the First and Fourth Amendments").

34 Government-run broadband may indeed have a valuable place where private markets do not provide broadband service. While some of the same pratfalls remain, so long as it is recognized that there will likely be ongoing needs for subsidization of networks in unserved areas, there may well be a role for municipal networks where there is no competitive alternative.

Book Reviews

Law and Judicial Duty

By Philip Hamburger

*Reviewed by Paul Horwitz**

Philip Hamburger's *Law and Judicial Duty* is an incredible book. Of the books I have reviewed in these pages in the last two years, it is simply the richest and best of the lot. Every constitutionalist, everyone interested in the history of the Anglo-American judicial craft, and everyone who cares not only about history but about contemporary debates over the nature and legitimacy of judicial review must read this book.

The debate over judicial review is not a uniquely American one, but it has reached dizzying heights (and, alas, depths) in this country. And it is not just an academic debate. In the United States, every judicial nomination, every landmark decision, and even many relatively trivial or momentary issues kick up the traces of the judicial review debate. Perhaps this is unsurprising in a nation about which Tocqueville once observed that "scarcely any political question arises in the United States that is not resolved, sooner or later, into a judicial question." And so questions that might have limited themselves to dry discussion in seminar rooms end up the stuff of sound-bites and blog comments. Do judges have the power to declare the law of the land? What gives them that right in the face of our representative system of government? Can courts overturn the duly arrived-at decisions of the political branches? And when they do, when are they being loyal to the Constitution, and when are they being "judicial activists?"

The discussion of these questions generally starts, if it does not stop—it never stops!—with Chief Justice John Marshall's opinion in *Marbury v. Madison*, which has traditionally been taken as the first decision setting out in full the power of the courts to hold both the executive and the legislative branches to their legal obligations, and to declare void an act of law that is "repugnant to the Constitution." For years, *Marbury* has been the case with which constitutional law professors begin their students' long journey into (and away from) the Constitution. That is not because *Marbury* states an unanswerable case for judicial review. To the contrary, constitutional law professors have begun with *Marbury* because they know a good target when they see one. Like many great (not good) constitutional law opinions, *Marbury* is magnificent but also deeply flawed. Any constitutional law professor worth his salt can easily spend a week belittling it, even if he comes to the conclusion (as most of us do) that there is something that just is *right* about it.

In recent years, a number of constitutional historians have questioned the received wisdom that *Marbury* is the germinal moment of American judicial review, finding traces of judicial review in a handful of federal and state opinions that preceded it. Hamburger thinks that is still not enough. His answer to the question of where judicial review began is like that of the lady in the Palmolive commercials: he looks at centuries of English and American jurisprudence and tells us, "You're soaking in it." Hamburger writes that his journey into English and American legal history convinced him that "'judicial review' is a misnomer and that what Americans in retrospect call 'judicial review' was a much broader and more interesting phenomenon."

Hamburger argues that Anglo-American judges have had an ancient "office or duty to decide in accord with the law of the land in all of their decisions." This did not just include what we would today think of as constitutional decisions, particularly in the American sense of decisions dictated by a supreme constitutional text. Rather, even before the birth of written constitutions as such, judges understood certain constitutional principles to be "the law of the land," and showed by their decisions that these principles could "render any unconstitutional government act unlawful and void." That did not include acts of Parliament, but it included many subordinate legal acts—and, once the scene shifted to the colonies and the new American nation, it brought legislative acts within the purview of the judicial office as well.

At the same time, in Hamburger's telling, the obligation to rule in accordance with the law of the land was not a freestanding license to do as judges wished. Implicit in the judicial office was a sense of "judicial duty." Judicial duty was at once "more general and more mundane than what has come to be understood as judicial review, and it therefore had greater authority and more balanced implications." Judicial duty simultaneously reminded judges of their duty to overturn unlawful actions and fortified them in the face of massive political pressure to the contrary, and "confined the judges to making such decisions in the same way they made any other decisions—in accord with the law of the land."

In marrying judicial duty to the judicial office, Hamburger reclassifies the question of judicial review not simply as a jurisprudential one, but as one that turns on "deeper anxieties about human nature." He places the judge as human subject at the center of debates over judicial review, in a way that is alive to both the judges' human virtues—their ability to "use their ideals to rise above their worst tendencies"—and their flaws, their final inability to "rise above the nature of men." If Hamburger's historical vindication of judicial review is not a perfectionist account, neither does it assume the impossibility of judges doing their duty as best they could in light of the obligations of their office.

Both the sense of authority and the sense of limitation that Hamburger finds in his judicial subjects are captured in a central idea—that of the judicial oath, which binds the judge to his duty in the very act of empowering him to decide. "A judge had a lonely task," Hamburger writes, "for by virtue of his oath, the obligation of judicial office rested on him as an individual. Not the judiciary, nor even a particular court, but each judge took the oath of office." Hamburger emphasizes the religious nature of the oath, and its consequences. The oath could not overcome all human imperfections, but it could straighten them, by reminding judges of a duty that "reached from the law of the land all the way up to heaven." Five centuries later, it is startling to see just how closely the judges' oaths, which required them "to administer justice indifferently, as well to

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the poor as the rich," in the words of Lord Chancellor Wolsey, resemble our own.

It is equally evident from the roll call of names and deeds that Hamburger summons forth from the past that the oath was never a perfect guarantor of judicial duty, and we might conclude for that reason that some of this was always window dressing, even when the religious aspects of the oath were at their most commanding for the judges who took them. But Hamburger still performs a signal service, both in reviving the importance of the oath in capturing a sense of individual judges' duties and pressures, and in resisting the conclusion that judges were and are governed only by will without constraint.

Although this is simply a magnificent book, it leaves the reader with one major regret. It is truly a shame that Hamburger's history draws to a close more or less in the age of *Marbury*. Hamburger makes a convincing case that it is a mistake to date the American experience of judicial review from 1803. But to evaluate some of the broader lessons about judicial review that Hamburger appears to want to take from the pre-*Marbury* history, it would help to know what has happened to judges' conception of their office and their duties in the two centuries since then. At more than 600 pages, Hamburger's book is perhaps long enough, but it would be dangerous to draw contemporary conclusions too strongly from this magisterial work without filling in that important gap. Perhaps we can hope for a sequel.

As this suggests, there is also room to cavil at Hamburger's conclusions, which are vague enough to be difficult to engage on their own terms but strong enough to leave room for doubt. Hamburger aptly observes that "the common law ideals of law and judicial duty" were less likely to flourish in an extended and diverse society like that of modern America. Our society may have less room for, and a murkier vision of, a set of "inexplicit assumptions" about "the authority of the people, the obligation of their intent, and the duty of the judges." And in a society in which the oath and other obligations are more bureaucratized, less personal, and less religiously grounded than they once were, words like "judicial duty" may become "little more than verbal snippets."

But it is a little too easy, I think, and a little too unhelpful, to simply conclude by lamenting that today's judges have lost sight of the "ideals of law and judicial duty," that "American judges have acquired a taste for power above the law." Hamburger is clear that yesterday's judges were not always paragons of judicial duty, and that the sticking power of their oaths can be appreciated only after viewing their work in a longer historical time frame. Certainly most judges today, a century after the rise of Legal Realism, still believe that they are attempting to do their duty and not simply exercise their will, even if the religious force of the oath no longer binds them as forcefully as it once might have. If they are wrong about this, so be it; but we might give today's judges, too, a couple of centuries before we are ready to speak too confidently about that. Nor will Hamburger's lament for the lost power of the oath, and of the concept of judicial duty, be very helpful if readers conclude that the remedy can only lie in retrieving an unrecapturable past. It may be that we can find new ways of hearing, understanding, and living up to the judicial oath. I believe we can. But that will take an act of imaginative reconstruction, building a new sense of the oath on a mix of ancient and decidedly modern values; it will not succeed by dint of mere nostalgia.

Still, there can be no doubt that *Law and Judicial Duty* is a monumental work. Anyone who wants to enter today's debates over judicial review would be well advised to first share Hamburger's journey into the old debates on these very questions.

The Law Market

By Erin A. O'Hara & Larry E. Ribstein

*Reviewed by Thom Lambert**

French political economist Frederic Bastiat once had a "market epiphany" of sorts. In chapter 18 of *Economic Sophisms*, he describes a thought he had on a visit to Paris:

> I said to myself: Here are a million human beings who would all die in a few days if supplies of all sorts did not flow into this great metropolis. It staggers the imagination to try to comprehend the vast multiplicity of objects that must pass through its gates tomorrow, if its inhabitants are to be preserved from the horrors of famine, insurrection, and pillage. And yet all are sleeping peacefully at this moment, without being disturbed for a single instant by the idea of so frightful a prospect.

The Parisians slept soundly, Bastiat realized, because they had confidence that markets—individual actors' exchanging goods and services for the primary purpose of benefiting themselves—would supply precisely what they needed for survival and comfort. Indeed, in a modern market economy, a consumer can buy just about any commodity or service she needs or desires, and a supplier can accumulate tremendous wealth by catering to consumers' wishes.

With this view in mind, the message of *The Law Market*, a new book by law professors Erin O'Hara (Vanderbilt) and Larry Ribstein (University of Illinois), is fundamentally optimistic. O'Hara and Ribstein argue that under contemporary choice-of-law rules, individuals and businesses are largely able to choose the law governing their lives, that this ability to choose puts pressure on governments to supply desirable legal regimes, and that this combination of demand and supply generates what is effectively a market for law. Because markets generally enhance human welfare, the law market's emergence seems worthy of celebration.

The bulk of the authors' argument, however, is positive rather than laudatory. First, they purport to show that people do, in fact, largely choose the law that will govern their affairs. They do so in at least two ways. First, they select their location—that is, they avoid those jurisdictions whose law they dislike or would like to avoid, and they pursue contacts with jurisdictions whose law they favor. Second, they design the laws that govern them by inserting choice-of-law or choice-of-forum clauses into their contracts. Nowadays, such clauses are widely enforced.

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This second act forms one of the most interesting discussions in the book. One might expect that forum courts would be reluctant to apply foreign law (pursuant to a choice-of-law clause) or to cede jurisdiction (pursuant to a choice-of-forum clause). But courts face pressure from exit-affected interest groups--local groups whose interests will be adversely affected if businesses exit or avoid the state because they cannot bargain for the legal rules they find desirable. Local lawyers specializing in franchising, for example, would lose business if franchisors avoided their state because its franchise laws were deemed unfavorable and the franchisors were unable to contract for another state's law. Those exit-affected lawyers would lobby for enforceable choice-of-law clauses. Their pressure may generate legislation requiring judges to enforce such clauses, and even absent such legislation, judges would likely respond to the exit-affected group's political pressures because the judges are beholden to the state legislature and, in many states, are themselves elected.

Moreover, there is the availability of arbitration as an alternative to adjudication. The Federal Arbitration Act (1925) binds both state and federal courts to enforce arbitration provisions in contracts. Because parties have a broad right to opt for arbitration (in which they can largely choose their governing law) if they disfavor a state's substantive law and are not permitted to choose the law of another state, state courts have little incentive to insist upon applying their own law. Doing so will simply motivate parties to include arbitration provisions in their contracts. Thus, in a world with liberal rights to select arbitration, state courts are more likely to honor parties' other choices concerning judicial forums and applicable law.

The downside of a broad ability to opt out of a forum state's law is that it impairs the state's ability to impose even sensible, "good" regulations. Thus, O'Hara and Ribstein maintain, "the challenge is to foster the beneficial aspects of the law market with enforcement of choice-of-law clauses while simultaneously protecting states' ability to impose reasonable regulation." Current choice of law rules attempt to strike the appropriate balance by taking into consideration parties' contacts with the state whose law is selected and the public policy limitations of states with a greater interest in the parties' dispute. The governing choice-of-law principles are, however, clumsy and unpredictable, providing parties with little ex ante guidance.

O'Hara and Ribstein therefore conclude by proposing a federal choice-of-law statute that would enhance predictability while striking an appropriate balance between parties' desire to select their governing law and states' need to regulate. Under the proposed statute, states would be required to enforce contractual choice-of-law provisions unless a state statute explicitly provided otherwise. This approach, the authors argue, would permit state legislatures to declare certain state laws "super-mandatory" (i.e., incapable of evasion by a contractual choice to be regulated by another state's law). At the same time, the presumption is that choice-of-law and choice-of-forum clauses are enforceable, and the requirement that exceptions to that presumption be set forth in statutes rather than by judges making decisions in particular cases would "provide[] clear notice to companies that a particular state will not allow them to choose their governing law" on a particular matter. Armed with such notice, firms may "respond by altering their business practices or exiting that state's product markets." The proposed statute, in short, would make the existing law market more efficient by reducing the costs of adjudicating whose law governs and providing predictability to parties.

Given the obvious and substantial benefits markets provide, one might expect *The Law Market* to assert the normative argument that individuals *should* be able to employ choice-of-law clauses to "buy" their governing laws from competing jurisdictions. But O'Hara and Ribstein aim to speak positively rather than normatively. They describe the existing law market, highlight the difficulty it can create for states desiring to regulate harmful activities, and explore how parties choose, or could choose, applicable law on a number of matters ranging from corporate governance to payday loan terms to same-sex marriage. The only major normative argument expressly asserted by the authors is that the U.S. Congress ought to streamline the existing and inevitable law market by enacting the federal choice-of-law statute mentioned above. Notably, the authors do not take a position on whether parties *should* be able to opt out of state laws they find overly chafing.

Yet one cannot read *The Law Market* without detecting an affinity for private ordering over regulation. Indeed, in a recent discussion of *The Law Market* on the popular Conglomerate weblog (http://www.theconglomerate.org), University of Virginia law professor Paul Stephan referred to "the normative impulse that lies at the heart of *The Law Market,*" confessing, "the extent of the normative ambition of *The Law Market* leaves me breathless." He then went on to discuss the authors' normative "argument that individuals ought to be free to form the kinds of family unions they wish in jurisdictions that allow them to do so, and that other states should respect those choices when members of those unions later move." Similarly, Professor Joel Trachtman of Tufts observed that O'Hara and Ribstein "do not argue that free choice should be the rule, but they argue … that it should be the rule more often (implicitly asserting that under current conditions it is not the rule enough)."

Responding to these characterizations of *The Law Market*, Professor Ribstein, purporting to speak for his co-author as well, wrote that "[t]he book is almost entirely a *positive* analysis of the market that we in fact have—*not* a *normative* argument in favor of having such a market." He continued:

> The central question in the book therefore is *not* whether parties *should* be able to *choose* the applicable law, but whether and to what extent they should be able to make that choice *by ex ante contract*. The book's sole normative conclusion is not that choice is good, but that contract is a better analytical starting point in making this choice than any other alternative that has come along.

This reluctance to concede the normative commitments that Professors Stephan and Trachtman (and I) inferred is curious. In his Conglomerate response, Professor Ribstein maintained that he and O'Hara had eschewed an assertion that parties should be able to contract for their governing law because the authors "were not prepared to offer the normative framework that would support that conclusion." (Indeed, Professor Stephan's primary criticism was that O'Hara and Ribstein had not adequately

defended the book's implicit normative commitment by "fully assembling the case for liberty and autonomy.") It seems to me, though, that O'Hara and Ribstein have made a fundamentally normative argument, that the normative position they endorse is both right and necessary to support the federal statute they propose, and that clarifying the scope of the law market would have eased the authors' burden of justifying their implicit normative commitment.

Currently, contractual choice-of-law clauses are generally enforceable unless the parties have no connections to the jurisdiction whose law is chosen or unless enforcement would undermine a fundamental policy of the jurisdiction whose law would govern but for the contractual provision. O'Hara and Ribstein have argued for a rule that would presume the enforceability of choice-of-law clauses unless the legislature of the forum state has provided by statute that its own substantive law on the matter at issue is "super-mandatory." If, as seems likely, the O'Hara/Ribstein statute would result in the enforcement of more choice-of-law clauses than does the currently applicable approach, then the recommended statute implicitly favors expansion of parties' ability to choose their own law.

Moreover, to the extent O'Hara and Ribstein seek to justify their proposed choice-of-law rule on grounds that it will generate jurisdictional competition that will produce better laws, they are at least implicitly setting forth a normative argument that parties generally *should* be able to choose the law governing their affairs. In his comments on the Conglomerate weblog, Professor Ribstein insisted that the book did not assert "that regulatory competition results in 'superior' law." But consider this passage from the book's final chapter:

> We have shown how this market can discipline lawmaking by forcing states to compete with each other. Moreover, contractual choice of law better enables states to experiment with alternative solutions to difficult policy problems. Enforcing choice-of-law clauses will help legal improvements to evolve more quickly and effectively.

Is that not a (compelling!) normative argument in favor of enhancing individuals' ability to choose their governing law? And do the authors not *need* some sort of "law improvement through jurisdictional competition" argument to justify the fairly significant federal intrusion their proposed federal choice-of-law statute represents? Absent the benefits of jurisdictional competition, the case for the proposed statute rests on the benefits of easier adjudication and enhanced predictability for contracting parties. Those are, of course, substantial benefits, but the case for the proposed statute becomes far more persuasive if supplemented with the normative argument that it will ultimately facilitate law-improving jurisdictional competition.

While I would have preferred that the authors embrace more fully the benefits of the law market whose existence they document, I am admittedly inclined toward private ordering and skeptical of state intervention in private affairs. (My own skepticism arises primarily from two sources: a Hayekian belief that centralized regulators are not privy to the time- and place-specific information needed to direct resources in a way that maximizes human welfare and a Public Choice-informed belief that legislators and regulators remain rational self-interest maximizers when they step into the public arena and therefore make decisions that inure to their own, and not necessarily the public's, benefit.) Perhaps O'Hara and Ribstein wanted to avoid "preaching to the choir" and therefore sought to craft an argument that would appeal to readers who, unlike me, are not generally skeptical of government efforts to regulate private affairs. The back-and-forth between Professors Stephan and Ribstein on the Conglomerate weblog suggests that that impulse may have motivated the authors to temper their praise for the law market.

But the authors probably could have asserted normative arguments that would have appealed even to non-libertarians had they more explicitly defined the law market's domain. To see its limited, albeit quite broad, domain, consider the various ways legal duties arise. Some duties (e.g., most tort duties, criminal law obligations, health and safety regulations, and property use restrictions) are imposed from the "top down" by judges or legislators seeking to protect the interests of innocent potential victims who do not have the opportunity and/or ability to engage in ex ante contracting with their potential victimizers. Other duties (e.g., contract obligations, marital duties and rights, the obligations of members of business organizations, property transfer duties, even product liability and medical malpractice duties, which may be conceived of as creatures of contract) are created from the "bottom up" as parties assent to be bound in a certain manner. Contractual choice of law permits parties to select their duties falling into the latter category, in which ex ante contracting over duties is possible, but not the former, in which it is not. Thus, the law market's domain is limited to the realm of "bottom up" legal duties that are created by assent. Those duties generally are not aimed at protecting third parties who lack the opportunity to protect their interests via contract. The upshot of this limited domain is that, even with a vigorous law market, states have largely unfettered freedom to regulate to prevent harmful third-party effects.

The sort of regulation that cannot be impaired by the law market—that aimed at protecting innocent third parties (or preventing negative externalities)—probably represents the "most legitimate" species of regulation, the type of regulation that most people would agree lawmakers ought to be able to impose. Once one has removed such regulation from the scope of party choice, so that it is clear that the law market impairs states' abilities only to impose rules not aimed at protecting innocent third parties, the normative superiority of both the law market and the proposed federal choice-of-law statute becomes more apparent. Laws and regulations not aimed at avoiding adverse third party effects—e.g., those positing default rules for business organizations or purporting to shape citizens' preferences in some particular manner—are less likely to be welfare-maximizing than are the externality-regulating laws that parties cannot avoid via contractual choice of law. Thus, those more suspect rules should be immune from contractual evasion only where the legislature has mustered the political will to declare them super-mandatory (i.e., incapable of being evaded via a choice-of-law clause).

One of the most important metrics for evaluating the success of an academic work is the degree to which it sparks further questions. (Consider, for example, the scores of scholarly inquiries inspired by Ronald Coase's articles *The Nature of the Firm* and *The Problem of Social Cost*.) Evaluated along this dimension, *The Law Market* must be deemed a smashing success. Among the many questions it inspires are: To what degree have law markets, like commodity markets, accommodated the needs and desires of niche groups? How have law markets "punished" suppliers of inferior products? By what precise mechanisms are judges, especially those who are not elected, motivated to honor parties' choices of governing law? Can we better articulate substantive criteria for when courts should refuse to apply selected law? Inspired by *The Law Market*, I look forward to pondering those questions as I continue my own exploration of the law.

Judgement Calls: Principle and Politics in Constitutional Law

By Daniel A. Farber & Suzanna Sherry

*Reviewed by Donald A. Daugherty, Jr.**

Although it claims to reject interpretive schools on both the left and the right in favor of a "middle ground," *Judgment Calls* is another effort to propose a way to interpret the Constitution without relying on the publicly-understood meaning of the document's express provisions at the time they became law. The authors, Daniel A. Farber of the University of California-Berkley and Suzanna Sherry of Vanderbilt University, assert that they seek a way between strict constructionist theories, in which judges are wholly constrained by objective criteria, and a cynical legal realism, in which judges act as quasi-legislators reading the founding document in the way that satisfies their political preferences. Although *Judgment Calls* offers some interesting discussion, the book ultimately fails to deliver the promised middle way.

Farber and Sherry attempt to show an approach to constitutional interpretation that is both principled and flexible, and one that reconciles the democratic rule of law with the inevitability that judges will have some discretion. The book offers various examples of the strict, "overly principled" end of the spectrum (e.g., originalism, intratextualism, minimalism), but it is unclear who follows the "overly flexible," political school. In any event, Farber and Sherry explain how they believe judicial discretion can be exercised responsibly in constitutional decisionmaking, they describe the existing constraints that guide and contain such discretion, and recommend various improvements (e.g., favoring foxes on the bench over hedgehogs; enlarging the mandatory jurisdiction of the Supreme Court; emphasizing actual practice experience in hiring law school faculty).

The authors do not review the text of the Constitution in *Judgment Calls*, which could be explained by the fact that the book is an extended essay on the decisionmaking process generally, not a close consideration of what specific portions of the founding document mean as a legal matter. The authors write, however, that the absence of any textual analysis in their book is because the text "usually does not offer much in the way of either guidance or constraint;" this remarkable assertion reveals the authors' bias towards an overly flexible, political approach, undermining their claim of seeking some "middle ground."

A major assumption of *Judgment Calls* is that "[m]any key constitutional cases leave judges with leeway because the results are not clearly dictated by any source of constitutional authority, whether the language of the Constitution, its history or precedent." At the same time, the authors believe that "this leeway does not preclude reasoned decision making."

The authors write that when a constitutional question cannot be answered by the Constitution itself, the process must safeguard against judges "either freely imposing their own values or deciding cases on a purely ad hoc basis." Of course, they do not consider whether the Constitution's silence may mean that the issue is not "constitutional" as a threshold matter, but is left to the political processes and/or states for resolution. Nonetheless, *Judgment Calls* provides a worthwhile review of the constraints on judicial discretion that exist apart from the law itself, such as our hierarchical court structure, the give-and-take among members of appellate courts during the deliberative process, the public and scholarly scrutiny of judicial decisions, and the institutional pressure towards transparency in the reasoning that supports a court's holding. Under an originalist approach, these constraints serve to reinforce the law, which is what judges are supposed to be interpreting in the first place. But the safeguards identified by Farber and Sherry are useful, additional deterrents against judges who would otherwise be prone to follow their personal notions of the best policy.

The authors' thesis is that judicial decisions can be judged on the basis of "[a] standard of reasonableness—whether their readings of text are plausible, whether they consider all of the relevant factors (but not others), whether they acknowledge and adequately account for competing considerations, whether they articulate plausible distinctions and intelligible standards—in short, on the basis of the strength of their legal reasoning." However, the rub is whether that reasoning must adhere to the text's original meaning or, with the help of the many other "tools" purportedly available to the judge, can diverge from that meaning.

Where originalists believe in the primacy of the text as it was generally understood, *Judgment Calls* treats textual meaning as merely another tool in a judge's toolbox. As Justice Breyer has pointed out, he uses the same tools as Justice Scalia to arrive at a decision, but just has some additional ones.[1] Thus, the judge's toolbox may also contain, for example, "'evolving standards of decency,'"[2] rights that migrate into the Constitution without need of the Article V amendment process,[3] empathy for particular categories of litigants over others,[4] or foreign law.[5] Without fail, these extra tools help to construct decisions that happily coincide with the judge's own view of what the Constitution requires.

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The need for a variety of additional tools can be understood when it is considered that the greatest "flexible" decisions—e.g., *Roe, Miranda, Lawrence*—have little or no relation to the language of the Constitution. Thus, a judge must have more tools that he or she can employ to achieve a righteous decision. The text and its original meaning are important tools but in the middle ground of *Judgment Calls*, they are only two of many and, when they are an impediment to the correct result, can be ignored.

Judgment Calls points to "constitutional values" as a source of authority, which seems reasonable enough. Who could argue that "constitutional values" are not relevant to interpreting the Constitution? On closer inspection, however, it appears that the term may be little more than cover for a judge's notions about, for example, contemporary values. To "make value judgments," the book instructs judges to look to constitutional values. But considering "[h]ow... should judges go about identifying constitutional values?," the authors ignore completely the obvious answer: read the Constitution. Rather, *Judgment Calls* invites judges to look elsewhere, allowing that "broad support for a value, even if not consensus," can be enough to elevate it to a constitutional level. Notably, discussion of the use of "constitutional values" follows on the heels of a discussion of "contemporary social values," in which the authors acknowledge that "[e]veryone agrees that the text and original understanding are relevant factors," along with precedent, but that fundamental disagreement remains over contemporary values. Like "judicial activism," tools such as "contemporary values" may not poll well in the public debate over the role of judges, which would explain efforts to find a substitute bottle for old wine.

That "contemporary values" has become pejorative would not be surprising. Besides being an illegitimate method, judicial consideration of current values makes no sense as a practical matter. Assuming that today's values are categorically better than yesterday's, why is it that the Supreme Court justices have a better sense of the values currently held by Americans than the broad cross-section of citizenry represented by democratically elected legislators and executives from all regions of the country at both the state and federal level? The far better, and only legitimate, method for gauging the values held by citizens is through the opinion polls that our democracy conducts regularly at the ballot box. Standards of decency and the like evolve to become firmly implanted among our national values when they are made law through federal statute, Constitutional amendment or by an overwhelming majority of states, not when five to nine lawyers in Washington, D.C., believe that they are there.

Also showing an inclination towards politics over principle, Farber and Sherry sprinkle *Judgment Calls* with unnecessary asides that detract from their credibility. This is most evident in the final chapters, which apply the book's interpretive approach to jurisprudence in three of the most contentious constitutional areas—terrorism, abortion and affirmative action. For example, the authors write, "We are no fans of the Bush Administration's handling of terrorism issues or foreign policy, but [*Hamdi*] obviously presented a very serious and difficult constitutional issue." Similarly, although they recognize that the approach of the *Casey* dissenters to stare decisis was superior to that of the majority, the authors feel compelled to state that "we think they were quite wrong on the merits of the abortion decision." Similarly, the authors note the problematic aspects of *Grutter*, but make certain their readers know that by doing so, they do not mean to suggest "that the Court was necessarily wrong to uphold the law school's affirmative action program, but to show that the Court failed to provide a tenable argument for doing so while striking down the undergraduate admissions program" in the companion case, *Gratz*. This apparent anxiety about potential accusations of political incorrectness is surprising from law professors who in the past have unflinchingly challenged radical multiculturalism in their academy.[6]

In closing, the authors recognize that their "prescription for judges is perhaps deceptively simple: Respect precedent, exercise good judgment, provide reasoned explanations, deliberate with your colleagues, and keep in mind the possible responses of critics." However, their articulation of their prescription reinforces the conclusion that the authors do not achieve what they set out to do. Transparency, peer review, etc., are essential to any defensible, intellectually honest exercise. They are no less important to drafting legislation (or, for that matter, writing a graduate school dissertation or preparing a business plan for potential investors) than they are to constitutional decisionmaking. The authors' prescription applies to so many other activities that it tells little specifically about the very subject of the book.

Although *Judgment Calls* may be a good try, its aim of finding a middle way was doomed from the start. Principle and flexibility are simply not equally important for making legal decisions. Even where the meaning of the Constitution is susceptible to more than one plausible interpretation, constitutional law must always be founded on principles drawn directly from, if not expressly in, the Constitution itself. Constitutional analysis cannot start from (and, ultimately, return to) any place other than the meaning of the text as reasonably understood by the majority that originally consented to elevate it from mere words on paper into governing law. To do otherwise is to "reduce[] to nothing what we have deemed the greatest improvement on political institutions—a written constitution."[7]

Endnotes

1 See "A Conversation on the Constitution: Perspectives from *Active Liberty* and *A Matter of Interpretation,*" ABC (Dec. 5, 2006), *available at* http://www.fed-soc.org/publications/pubID.173/pub_detail.asp.

2 *See* Kennedy v. Louisiana, 554 U.S. ___, 128 S.Ct. 2641, 2649 (2008).

3 *See generally* Cass Sunstein, The Second Bill of Rights (2004).

4 The President's Remarks on Justice Souter, http://www.whitehouse.gov/blog/09/05/01/The-Presidents-Remarks-on-Justice-Souter/ (May 1, 2009, 04:23 EST).

5 *See* Lawrence v. Texas, 539 U.S. 558, 598 (2003).

6 *See generally* Farber & Sherry, Beyond All Reason (1997).

7 Marbury v. Madison, 5 U.S. 137, 178 (1803).

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