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Letter from the Editor

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Sincerely,

Katie McClendon

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Could a New Section 1983 Covering Federal Officials Curb Executive Branch Abuse of Constitutional Rights?

By J. Kennerly Davis, Jr.

Note from the Editor:

This article notes public distrust of the federal government in light of recent scandals, and proposes that a new federal statute authorizing civil rights lawsuits against federal officials could help to mitigate that distrust.

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• H. Allen Black, *Balance, Band-Aid, or Tourniquet: The Illusion of Qualified Immunity for Federal Officials*, 32 William & Mary L. Rev. 733 (1991), http://scholarship.law.wm.edu/cgi/viewcontent.cgi?article=1937&context=wmlr.

• David Zaring, *Personal Liability as Administrative Law*, 66 Wash. & Lee L. Rev. 313 (2009), http://scholarlycommons.law.wlu.edu/cgi/viewcontent.cgi?article=1046&context=wlulr.

• John C. Jeffries, Jr., *What's Wrong with Qualified Immunity?*, 62 Florida L. Rev. 851 (2010), http://www.law.virginia.edu/pdf/faculty/hein/jeffries/jeffries_2010_62flalrev851.pdf.

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Professional commentators have expressed their surprise at the extent to which the national political establishment was upended in the 2016 election cycle by the populist campaigns of unconventional outsiders. But the experts should have seen it coming. The trust and respect that Americans feel for the federal government, and the officials who staff it, have been on the decline for years.

In September 2015, Gallup reported that trust in government is the lowest it has been in a decade. Seventy-five percent of Americans believe corruption is widespread in the government. Fewer than one in five Americans trust Washington to do what is right on a regular basis, and almost half believe that government poses an immediate threat to the rights and freedoms of ordinary citizens.[1] At about the same time in 2015, the Pew Research Center reported that four in five Americans feel frustrated or angry with the government, fewer than half view the Department of Justice favorably, and one in four registered voters think of government as an enemy.[2]

Such widespread alienation and antipathy is not just disturbing; it's dangerous. Abraham Lincoln understood this better than most when he warned in his famous Lyceum Address that without the widespread, deeply felt support of the people, our system of government cannot endure. If the feelings of the citizens become alienated from the government, "it will be left without friends, or with too few, and those few too weak to make their friendship effectual" during a crisis.[3]

I. Executive Branch Abuse by Unaccountable Officials

How have we come to such a perilous point? Among the significant causes of our plight, we must surely include those frequently recurring cases of federal officials who overreach the bounds of their legitimate authority and abuse their office, violating due process and the constitutional rights of their fellow citizens in the process. The stories of abuse have become all too familiar: the systematic targeting by IRS officials of conservative

1 *75% in U.S. See Widespread Government Corruption*, GALLUP (Sept. 19, 2015), http://www.gallup.com/poll/185759/widespread-government-corruption.aspx?; *Trust in Government*, GALLUP (Sept. 13, 2015), http://www.gallup.com/poll/5392/trust-government.aspx?; *Half in U.S. Continue to Say Gov't Is an Immediate Threat*, GALLUP (Sept. 21, 2015), http://www.gallup.com/poll/185720/half-continue-say-gov-immediate-threat..aspx?.

2 *Beyond Distrust: How Americans View Their Government: General Opinions About The Federal Government,* Pew Research Center (Nov. 23, 2015), http://www.people-press.org/2015/11/23/2-general-opinions-about-the-federal-government; *Ratings of Federal Agencies, Congress and the Supreme Court*, Pew Research Center (Nov. 23, 2015), http://www.people-press.org/2015/11/23/4-ratings-of-federal-agencies-congress-and-the-supreme-court.

3 Abraham Lincoln, *Address to the Young Men's Lyceum of Springfield, Illinois* (Jan. 27, 1838), http://www.abrahamlincolnonline.org/lincoln/speeches/lyceum.htm.

organizations and individuals;[4] the raids by heavily armed inspectors of peaceful farms and factories;[5] the intimidating threats of prosecution or agency enforcement action that punish dissent and extract shakedown settlements;[6] and the retaliation against legitimate whistleblowers within the executive branch.[7] Is it any wonder that a large number of Americans view the federal government as an enemy?

Feelings of anger and frustration about such conduct are further increased by the fact that individual federal officials are seldom, if ever, effectively held to account for their abusive overreach. Stonewalled congressional hearings come to nothing. Impeachment is too cumbersome, and too extraordinary, to be considered a practical mechanism for enforcing accountability.[8] Slow-rolled internal agency reviews finally conclude with some shuffling of personnel and bland assurances of continued commitment to mission and service. The individual officials involved in these scandalous activities may, at worst, be reassigned with generous relocation payments, or they may retire with full pensions, benefits, and final bonuses.[9] They typically suffer no significant personal consequences for the rights they have violated, and the lives and livelihoods they have damaged.

With the legislative and executive branches of the federal government largely unable, or unwilling, to hold abusive officials accountable, the individuals whose rights have been violated have been left to seek redress on their own through the courts.

II. The Implied Right Under *Bivens* To Sue Abusive Federal Officials

Under current law, it is at least theoretically possible for an aggrieved citizen to sue federal officials as individuals and thereby seek to recover money damages from those officials to compensate the citizen for the harm caused by the rights violation. But lawsuits like this face legal obstacles that are virtually impossible to overcome. No federal statute explicitly authorizes this kind of suit.

In 1971, the U.S. Supreme Court found that Webster Bivens could sue to recover damages from agents of the Federal Bureau of Narcotics for their violation of his Fourth Amendment rights.[10] Although no federal statute authorized his suit, the Court found that Bivens had an implicit right to sue the officials, and that that right to sue was directly grounded in the Constitution itself:

> [A]s our cases make clear, the Fourth Amendment operates as a limitation upon the exercise of federal power…. It guarantees to citizens of the United States the absolute right to be free from unreasonable searches and seizures carried out by virtue of federal authority. And "where federally protected rights have been invaded…courts will be alert to…grant the necessary relief."[11]

Having concluded that Bivens had a right to sue under the Fourth Amendment, the Court held that he was entitled to recover money damages:

> Of course, the Fourth Amendment does not in so many words provide for its enforcement by an award of money damages for the consequences of its violation. But "it is… well settled that where legal rights have been invaded, and federal statute provides for a general right to sue for such an invasion, federal courts may use any available remedy to make good the wrong done…"[12]
>
> Having concluded that petitioner's complaint states a cause of action under the Fourth Amendment…we hold that petitioner is entitled to recover money damages for any injuries he has suffered as a result of the agents' violation of the Amendment.[13]

Since 1971, however, the courts have steadily chipped away at the *Bivens* decision, defining exceptions and exclusions and limitations such that little remains in case law to support a citizen's suit for damages against federal officials for their violation of his or her constitutional rights. When Congress has included any sort of meaningful remedial mechanism in a statute without also expressly preserving a *Bivens* remedy, the Supreme Court has become increasingly reluctant to imply a *Bivens* cause of action.[14] In a 2009 case involving a constitutional claim for damages, the Court confirmed that "implied causes of action are disfavored."[15] Some of the citizen lawsuits filed against IRS

4 Zachary Goldfarb & Karen Tumulty, *IRS Admits Targeting Conservatives for Tax Scrutiny in 2012 Election*, The Washington Post (May 10, 2013), https://www.washingtonpost.com/business/economy/irs-admits-targeting-conservatives-for-tax-scrutiny-in-2012-election/2013/05/10/3b6a0ada-b987-11e2-92f3-f291801936b8_story.html.

5 Bill Frezza, *Lumber Union Protectionists Incited SWAT Raid On My Factory, Says Gibson Guitar CEO*, Forbes Online (May 26, 2014), http://www.forbes.com/sites/billfrezza/2014/05/26/lumber-union-protectionists-incited-swat-raid-on-my-factory-says-Gibson-CEO.

6 Larry Kudlow, *The Obama Bank Shakedown*, National Review Online (Aug. 22, 2014), http://www.nationalreview.com/node/401696.

7 Joe Davidson, *VA Culture of Reprisals Against Whistleblowers Remains Strong After Scandal*, The Washington Post (Sept. 22, 2015), https://www.washingtonpost.com/news/federal-eye/wp/2015/09/22/va-culture-of-reprisals-against-whistleblowers-remains-strong-after-scandal/.

8 Only one appointed executive branch official has ever been impeached: Secretary of War William W. Belknap in 1876. *See William W. Belknap (1869–1876)*, Miller Center of Public Affairs, University of Virginia, http://millercenter.org/president/essays/belknap-1869-secretary-of-war.

9 Robert W. Wood, *IRS' Lois Lerner Got Pension, $129K Bonus, New Call For Criminal Charges*, Forbes Online (June 1, 2015), http://www.forbes.com/sites/Robertwood/2015/06/01/irs-lois-lerner-got-pension-$129K-bonus-new-call-for-criminal-charges.

10 *Webster Bivens v. Six Unknown Named Agents of the Federal Bureau of Narcotics*, 403 U.S. 388 (1971). Bivens alleged that federal narcotics agents had handcuffed him, searched his house, arrested him, interrogated him, and strip searched him, all without a warrant or probable cause, causing him emotional distress for which he claimed damages. *Id.* at 389-90.

11 *Id.* at 392 (quoting Bell v. Hood, 327 U.S. 678, 684 (1946)).

12 *Id.* at 396 (quoting Bell, 327 U.S. at 684).

13 *Id.* at 397.

14 Bush v. Lucas, 462 U.S. 367 (1983); *see also* Schweiker v. Chilicky, 487 U.S. 412 (1988).

15 Ashcroft v. Iqbal, 556 U.S. 662, 669 (2009).

officials for their political targeting of conservatives have been based on the *Bivens* decision, and they have been severely set back by how narrowly courts now read the *Bivens* decision in cases like this.[16]

It might be possible to revitalize the essential principle of the *Bivens* decision, and clearly establish the right of a citizen to sue for damages the individual federal officials who have violated his rights. Such a revitalization could be especially important in light of the lack of meaningful relief available to an aggrieved citizen through any other means. As Chief Justice John Marshall observed many years ago, "The very essence of civil liberty certainly consists in the right of every individual to claim the protection of the laws, whenever he receives an injury."[17]

III. The Statutory Right to Sue Abusive State Officials

A turbulent period in our nation's past provides a dramatic example of the kind of action that has been taken, and could be taken again, to protect the rights of citizens from abusive public officials. During Reconstruction, in 1870 and 1871, Congress passed a series of civil rights acts to facilitate enforcement of the rights set forth in the recently enacted Thirteenth, Fourteenth, and Fifteenth Amendments to the Constitution. One section of the Civil Rights Act of 1871 was later officially designated to be Section 1983 of the U.S. Code.[18]

Section 1983 provides an explicit basis for any citizen whose constitutional or legal rights have been violated by a person acting under state government authority to sue that person personally for money damages and equitable redress to account for the harm resulting from the rights violation. It provides that:

> Every person who, under color of any statute, ordinance, regulation custom, or usage, of any State or Territory or the District of Columbia, subjects, or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any rights, privileges, or immunities secured by the Constitution and laws, shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress . . . .[19]

Over the years, Section 1983 has become a powerful tool for individuals to enforce their rights and to hold abusive state actors accountable. The statute has been broadly construed to apply to virtually any sort of state action, authorized or not,[20] whether carried out by a government employee or associated private party.[21] Under Section 1983, citizens can sue for punitive damages,[22] and they can collect reimbursement for their legal bills if they prevail in their litigation.[23]

Section 1983 does not, by its terms, provide any immunity from liability for defendants. Nevertheless, over the years the Supreme Court has drawn on principles of common law to create absolute immunity from liability under the statute for government officials performing judicial, legislative, or prosecutorial functions.[24] Similarly, the Supreme Court has created qualified immunity from liability under the statute for government officials performing executive or administrative functions. Qualified immunity protects officials from liability unless their conduct violates a clearly established constitutional or statutory right.[25]

IV. The Civil Rights Act of 1871—for 2017

Congress enacted Section 1983 during Reconstruction to help protect the constitutional rights of citizens against abuses perpetrated by individuals acting under the authority of their state governments (mostly newly freed slaves whose rights were threatened by the KKK and other white supremacist groups that held sway over many public officials in the South at the time). Today, Americans have a growing concern about the threat posed to constitutional rights by individuals acting under the authority of the federal government.

In light of Americans' declining faith in federal government institutions and the scandals that apparently justify that loss of faith, Congress could revisit Section 1983 and the *Bivens* decision and give serious consideration to drafting and possibly enacting a federal version of Section 1983. The new statute could provide that:

> Any person or entity that, acting under color of law, or when clothed with the authority or delegated authority of any statute, regulation, directive, declaration, guidance, communication, custom or usage of any agency, department, office or other subdivision of the federal government, subjects or causes to be subjected, any citizen of the United States or other person within the jurisdiction thereof to the deprivation of any substantive or procedural rights, or privileges, or immunities secured by the Constitution and laws shall be liable to the party injured in an action at law, suit in equity, or other proper proceeding for redress. The party injured shall be entitled to recover payment for all losses suffered as a result of the

16 Linchpins of Liberty v. United States, Civil Action No. 2013-0777 (D.D.C. Oct. 23, 2014) (order granting defendants' motion to dismiss).

17 Marbury v. Madison, 1 Cranch 137, 163, 2 L.Ed. 60 (1803).

18 Civil Rights Act of 1871, a.k.a. the Ku Klux Klan Act, Pub. L. No. 42-22, 17 Stat. 13 (1871).

19 42 U.S.C. § 1983 (2016).

20 Monroe v. Pape, 365 U.S. 167 (1971).

21 Lugar v. Edmondson Oil Company, 457 U.S. 922 (1982); *see also* Edmondson v. Leesville Concrete Company, 500 U.S. 614 (1991).

22 Smith v. Wade, 461 U.S. 30 (1983).

23 The Civil Rights Attorney's Fee Awards Act of 1976, 42 U.S.C. § 1988 (2016).

24 Stump v. Sparkman, 435 U.S. 349 (1978) (judicial immunity); Eastland v. U.S. Serviceman's Fund, 421 U.S. 491 (1975) (legislative immunity); Imbler v. Pachtman, 424 U.S. 409 (1976) (prosecutorial immunity).

25 Harlow v. Fitzgerald, 457 U.S. 800 (1986); *see also* Anderson v. Creighton, 483 U.S. 635 (1987).

deprivation, including punitive damages, all attorney's fees and other costs incurred to obtain redress.

Perhaps the new statute could be titled "The Civil Rights Enforcement Act of 2017" and, if passed into law, designated to be Section 1984 of the U.S. Code.

Of course, the likelihood of enactment is small. The legislative process involves many steps and considerable uncertainty. Each proposal has to compete with thousands of others for the limited time and resources available to the members of Congress and their staffs. Few bills become law; most do not. Concerns are often raised about the risk of unintended consequences that could flow from proposed legislation. In this case, such concerns might be especially acute given the fact that it has taken the Supreme Court years to work out the differing types of immunity available to state actors under Section 1983.

Some legislators may, in light of the recent election results, feel that the new administration and Congress should be given a chance to work together to address issues of executive branch abuse before spending any time and resources to pursue the new legislation discussed herein. But while the most recent cases of abuse are always associated with the most recent administration, the threat posed to constitutional rights by the modern administrative state and its consolidated powers is ongoing no matter which party is in power. Elections can bring change and political accountability, but as James Madison reminds us in the *Federalist Papers*:

> The accumulation of all powers, legislative, executive, and judiciary, in the same hands, whether of one, a few, or many… may justly be pronounced the very definition of tyranny.[26]

> [And while a] dependence on the people is, no doubt, the primary control on the government; … experience has taught mankind the necessity of auxiliary precautions.[27]

Perhaps, upon thoughtful consideration, legislation like The Civil Rights Enforcement Act of 2017 might be seen as a worthwhile auxiliary precaution.

26 The Federalist No. 47, at 249 (James Madison) (George Carey and James McClellan ed., 2001).

27 The Federalist No. 51, at 269 (James Madison) (George Carey and James McClellan ed., 2001).

Finding the Denominator in Regulatory Takings Cases: A Preview of *Murr v. Wisconsin*

By Christopher M. Kieser

Note from the Editor:

This article discusses *Murr v. Wisconsin*, a regulatory takings case that the Supreme Court will hear in its upcoming term. The article summarizes the background of the case, presents the parties' arguments, and posits possible outcomes at the high court and the implications of each.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. We invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

About the Author:

Christopher M. Kieser is a law clerk to Judge Daniel A. Manion on the United States Court of Appeals for the Seventh Circuit. At the time of writing, he was a Fellow in the College of Public Interest Law at the Pacific Legal Foundation, where he was involved in preparing the Supreme Court briefs in Murr v. Wisconsin. He graduated magna cum laude from Notre Dame Law School in 2013 and cum laude from the University of Notre Dame with a Bachelor of Arts in History and Economics in 2010.

Introduction

Next Term, the Supreme Court will take up an important property rights case that has been nearly forty years in the making. At issue in *Murr v. Wisconsin*[1] is whether governments may treat two contiguous, commonly owned but legally distinct parcels of land as a single parcel for the purposes of regulatory takings liability. The answer to this "relevant parcel" question is often outcome determinative in regulatory takings cases.[2] But the Supreme Court has provided only very limited guidance on this question, and lower courts have split over whether to apply a presumption that contiguous parcels should be treated as a single parcel. The *Murr* case will bring that question squarely before the Court this fall. The result will have a significant impact on the scope of regulatory takings liability and owners' ability to make reasonable use of private property.

I. Factual and Legal Background

The Murr siblings—Joseph, Michael, Donna, and Peggy—own two contiguous parcels of land along the St. Croix River in St. Croix County, Wisconsin.[3] Their parents originally bought each lot separately, the first in 1960 and the second in 1963.[4] The Murr parents built a cabin on the first lot and then transferred title to their family-owned plumbing company.[5] They purchased the second lot as an investment property, and it has remained vacant ever since.[6] In the intervening years, both lots passed into the siblings' ownership—the first in 1994 and the second in 1995.[7]

The transfer of the two adjacent lots to common ownership activated a decades-old St. Croix County ordinance requiring that the two separate parcels be treated as one parcel.[8] Because the Murr siblings own both lots, the Ordinance prohibits them from developing or even selling the second parcel.[9] About a decade after the transfer, the siblings wanted to protect their cabin from repeated flooding and build it on higher ground.[10] In connection with that effort, they unsuccessfully sought a variance from the

1 The Supreme Court granted certiorari on January 15, 2016. 136 S. Ct. 890 (2016).

2 See discussion infra at text accompanying nn. 18-22.

3 Murr v. Wisconsin, 359 Wis. 2d 675, 2014 WL 7271581, ¶¶ 3-6 (Dec. 23, 2014), *available at* http://www.scotusblog.com/wp-content/uploads/2015/11/DisplayDocument.pdf.

4 *Id.* at ¶ 4.

5 Murr v. St. Croix Cnty. Bd. of Adjustment, 796 N.W.2d 837, 841 (Wis. Ct. App. 2011).

6 *Murr*, 2014 WL 7271581, at ¶ 4.

7 *Murr*, 796 N.W.2d at 841.

8 *Murr*, 2014 WL 7271581, at ¶ 6.

9 *Id.*

10 *Id.* at ¶ 7.

Ordinance that would have allowed them to either sell the second lot or use it as a separate building site.[11] Denial of the variance application left no doubt that the second lot could not legally be developed or sold. Because application of the Ordinance denied all use of or value in their second lot, the Murr siblings sued St. Croix County for a regulatory taking.[12] They sought compensation for the deprivation of their rights to build on, sell, or do anything with the second parcel.

The Supreme Court has explained that the Fifth Amendment's Takings Clause[13] applies not only when government directly condemns property through eminent domain, but also when a government regulation goes "too far" in restricting the use of property.[14] In most instances, such claims are evaluated under the multi-factor test articulated in *Penn Central Transportation Co. v. City of New York*,[15] which principally considers the economic impact of a regulation, the extent to which it has interfered with realistic "investment-backed expectations," and the "character of the government action."[16] While *Penn Central* recognized that some regulations harm property rights so much as to warrant compensation, property owners who rely on the multi-factor test face an uphill battle when they challenge regulatory takings in the federal courts.[17]

However, when a property owner is required "to sacrifice all economically beneficial uses in the name of the common good . . . he has suffered a taking."[18] Such a denial of use is a categorical *Lucas*-style regulatory taking; the *Penn Central* factors are irrelevant and the property owner is entitled to compensation if she is denied all economically viable use of land.[19] But courts cannot apply *Lucas* or *Penn Central* without first determining which property has been affected—in other words, what should be the "denominator" in the analysis.[20] For example, a regulation that prohibits the use of one particular acre would deny all economically viable use of a parcel that contains only that one acre, but restrict only 10 percent of a ten acre plot containing the regulated acre. That is why "[t]he first and perhaps most important issue in any regulatory takings claim . . . is identifying the portion of property that should be used for the analysis."[21]

The Murr siblings' case highlights the importance of the relevant parcel analysis. The Wisconsin Court of Appeals held that the Murrs had not suffered a taking because of the "well-established rule that contiguous property under common ownership is considered as a whole regardless of the number of parcels contained therein."[22] Since the Murrs own adjacent lots, one of which has a cabin on it, that categorical rule made their *Lucas* claim impossible. However, were the parcels considered separately—as they were purchased and intended to be used—the siblings could claim a denial of all economically viable use of the second lot. Therefore, the siblings' case is the textbook example of the relevant parcel analysis determining the outcome of an entire regulatory takings case.

II. Advent of "Parcel as a Whole"

The Wisconsin Court of Appeals applied a categorical rule that commonly owned, adjacent parcels of land are to be treated as a single parcel for the purposes of regulatory takings liability. Like many other courts that have reached this conclusion, the Wisconsin court traced the origins of the "aggregation" rule to *Penn Central*.[23] But the parties in that case did not argue for such a rule, the *Penn Central* Court did not purport to establish it, and no subsequent Supreme Court decision has endorsed it. Despite that, the "parcel as a whole" concept has become ubiquitous in potential parcel aggregation cases, significantly limiting the application of the *Lucas* per se takings rule.

In *Penn Central*, the owners of the historic Grand Central terminal in New York City argued that the city's designation of the terminal as a landmark effected a regulatory taking of the property.[24] The landmark designation prevented the Penn Central Transportation Company from expanding the historic terminal above its existing height, and so the company argued that its air rights above the terminal had been taken by the regulation.[25] It contended that there should be no legal distinction between cases involving "several rights in the same piece of land" and those concerning "one right in several 'pieces' (acres) of land."[26] The city responded to that precise argument in its brief, arguing that

11 *Id.* (citing *Murr*, 796 N.W.2d at 846 (affirming the denial of variance request)).

12 *Id.* at ¶ 8.

13 The Takings Clause of the Fifth Amendment provides: "nor shall private property be taken for public use, without just compensation." U.S. Const. amend. V.

14 Pennsylvania Coal Co. v. Mahon, 260 U.S. 393, 415 (1922).

15 438 U.S. 104 (1978).

16 *Id.* at 124

17 Despite this, *Penn Central* is actually an effective tool for property rights litigators. Because it is a multi-factor test, property owners often can clear the summary judgment hurdle and obtain either a favorable settlement or a jury verdict in their favor. At the appellate level, however, *Penn Central* claims rarely succeed. An analysis of 162 cases citing *Penn Central* in the First, Ninth, and Federal Circuits through December 31, 2011, revealed only four instances where the appellate court held a regulation to constitute a taking under the multi-factor test. *See* Adam R. Pomeroy, Penn Central *After 35 Years: A Three Part Balancing Test or a One Strike Rule?*, 22 Fed. Circuit B.J. 677, 692 (2013). Even considering only cases that reached the merits of a property owner's regulatory takings claim, plaintiffs prevailed in only four out of 41 cases. *Id.*

18 Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1019 (1992).

19 *See* Lingle v. Chevron USA Inc., 544 U.S. 528, 538 (2005).

20 *See* John E. Fee, Comment, *Unearthing the Denominator in Regulatory Taking Claims*, 61 U. Chi. L. Rev. 1535, 1535-36 (1994) ("What the Court [in *Lucas*] did not decide, however, is how to determine the relevant parcel of land that is subject to the regulatory taking inquiry.").

21 David Spohr, Note, *Florida's Takings Law: A Bark Worse Than Its Bite*, 16 Va. Envtl. L.J. 313, 345 (1997).

22 *Murr*, 2014 WL 7271581, at ¶ 5 (citing R.W. Docks & Slips v. State, 628 N.W.2d 781, 789-90 (Wis. 2001)).

23 *Id.* at ¶¶ 4-5; *see also* Zealy v. City of Waukesha, 548 N.W.2d 528, 532-33 (Wis. 1996) (relied upon in *Murr*).

24 *Penn Central*, 438 U.S. 104.

25 *See* Brief of Appellant at 9, *Penn Central*, 438 U.S. 104.

26 *Id.* at 26 n.23.

the airspace-taking theory was "based on the improper assumption that the landmark parcel *consists of two distinct properties*, the Terminal and the air rights above the Terminal."[27]

The Court applied its newly minted multi-factor test and held that the owners of Grand Central Terminal had not suffered a compensable taking by virtue of the city's designation of the terminal as a landmark.[28] In the process, it stated that takings law "does not divide a *single parcel into discrete segments* and attempt to determine whether rights in a particular segment have been entirely abrogated."[29] And so Penn Central could not divide out the air rights from the remainder of the parcel and assert what amounted to a *Lucas* takings claim as to that portion of the property.[30]

Another case often cited to support the "parcel as a whole" rule is *Tahoe-Sierra Preservation Council v. Tahoe Regional Planning Agency*.[31] The property owners in *Tahoe-Sierra* argued that they had been denied all economically viable use of their parcels after the Tahoe Regional Planning Agency imposed a temporary[32] development moratorium.[33] A majority of the Supreme Court refused to apply *Lucas*,[34] reasoning that to apply it would approve the same splitting of one parcel that the Court had rejected in *Penn Central*.[35] Because a fee interest in property also includes "the term of years that describes the temporal aspect of the owner's interest," the Court held that denial of all economic use for just a period of time is not a categorical taking.[36] Like in *Penn Central*, the *Tahoe-Sierra* Court simply rejected the division of one property to facilitate a *Lucas* taking. As in *Penn Central*, the focus was on the single parcel in its entirety, but did not purport to suggest any rule for aggregating two separate parcels in the takings analysis.[37]

Nevertheless, many lower courts have cited *Penn Central* for the proposition that commonly owned contiguous parcels should be aggregated. Some, like the D.C. Circuit, have applied something akin to a presumption of aggregation, while considering factors such as "the degree of contiguity, the dates of acquisition, the extent to which the parcel has been treated as a single unit, and the extent to which the restricted lots benefit the unregulated lot."[38] Others, like the Federal Circuit, have applied a multi-factor test and refused to aggregate adjacent parcels.[39] Still others, like the Wisconsin courts, view *Penn Central* as having created an absolute aggregation rule.[40] These three approaches have created a significant conflict amongst the federal and state courts and ultimately led to the Supreme Court granting certiorari in the Murrs' case.

III. Parties' Arguments

Against this background, the Murrs contend that *Penn Central* and *Tahoe-Sierra* support a presumption against aggregation of separate parcels. The siblings point out that both cases recognize that the base unit of property is the single parcel;[41] for example, *Tahoe-Sierra* focuses on "the metes and bounds that describe [a property's] geographic dimensions" when defining the "parcel as a whole."[42] As such, the Murrs ask the Court to hold that "a distinct and geographically defined parcel of land is presumed to be the takings unit."[43] Under the proposed presumption, "[a]ny party seeking to segment lesser interests or aggregate other parcels must prove that the facts warrant such unorthodox treatment."[44]

The Murrs importantly note that such a presumption would at once be consistent with the Supreme Court's often-expressed concern for avoiding bright-line rules and also possess "a degree of predictability that is consistent with fundamental understandings of property law."[45] A unanimous Supreme Court recently noted that, "[i]n view of the nearly infinite variety of ways in which government actions or regulations can affect property interests,

27 Brief of Appellee at 36, *Penn Central*, 438 U.S. 104 (emphasis added).

28 *Penn Central*, 438 U.S. at 138.

29 *Id.* at 130 (emphasis added).

30 *See* Concrete Pipe & Prods. of Cal., Inc. v. Const. Laborers Pension Trust for S. Cal., 508 U.S. 602, 644 (1993) (describing *Penn Central*'s holding as "that a claimant's parcel of property could not first be divided into what was taken and what was left for the purpose of demonstrating the taking of the former to be complete and hence compensable").

31 535 U.S. 302 (2002).

32 As Chief Justice Rehnquist noted in his dissent, the "temporary" moratorium on development "lasted almost six years." *Id.* at 345-46 (Rehnquist, C.J., dissenting). That is longer than the two years the regulation in *Lucas* was in effect before the law changed. *Id.* at 346.

33 *Id.* at 306 (majority opinion).

34 The Court's refusal to apply *Lucas* ended the case, as the property owners did not pursue their *Penn Central* argument past the district court. *Id.* at 317.

35 *Id.* at 330-31.

36 *Id.*

37 Some other cases are generally thought to support the parcel as a whole rule, but none support aggregation of two separate parcels. *See, e.g.*, Keystone Bituminous Coal Ass'n v. DeBenedictis, 480 U.S. 470, 498 (1987) ("There is no basis for treating the less than 2% of petitioners' coal as a separate parcel of property."); Andrus v. Allard, 444 U.S. 51, 65-66 (1979) (regulation preventing sale of certain artifacts was not a taking because courts must take the aggregate of the "bundle" of property rights into account). Nor do the cases cited by the United States in *Penn Central* support an aggregation rule. *See* Goldblatt v. Town of Hempstead, 369 U.S. 590, 594 (1962) (holding that prohibition of excavation below the water table was not an unconstitutional taking); Hudson Cnty. Water Co. v. McCarter, 209 U.S. 349, 355 (1908) ("[T]he police power may limit the height of buildings in a city, without compensation. To that extent it cuts down what otherwise would be the rights of property. But if it should attempt to limit the height so far as to make an ordinary building lot wholly useless, the rights of property would prevail over the other public interest, and the police power would fail."). These cases support the results in *Penn Central* and *Tahoe-Sierra*, but not the aggregation of separate parcels for the purposes of takings analysis.

38 District Intown Props. Ltd. v. District of Columbia, 198 F.3d 874, 880 (D.C. Cir. 1999).

39 *See* Lost Tree Village Corp. v. United States, 707 F.3d 1286, 1293-94 (Fed. Cir. 2013); Palm Beach Isles Assocs. v. United States, 208 F.3d 1374, 1381 (Fed. Cir. 2000).

40 *See R.W. Docks & Slips*, 628 N.W.2d at 789-90.

41 Brief for Petitioner at 24, *Murr*, 136 S. Ct. 890.

42 *Tahoe-Sierra*, 535 U.S. at 331.

43 Brief for Petitioner at 24, *Murr*, 136 S. Ct. 890.

44 *Id.*

45 *Id.* at 25.

the Court has recognized few invariable rules in this area."[46] But some predictability is necessary to give both property owners and governments a baseline. The Murrs' baseline is the state-drawn lot lines. This places the emphasis on objective factors and requires the government to come forward with a persuasive reason why two legally-distinct parcels should be treated as one.

Further, the Murrs argue that presuming the primacy of the parcel as the denominator in regulatory takings cases is consistent with the traditional understanding of American property law.[47] The fee simple parcel "is an estate with a rich tradition of protection at common law,"[48] not an unusual device used to create takings liability. The particular parcels in this case were created by Wisconsin law in 1959 and were owned by distinct owners until 1995.[49] As separate fee simple parcels, the Murrs argue that they have always had the right to possess, use, and convey both the investment lot and the cabin lot irrespective of the two lots' common ownership.

Finally, the Murrs emphasize that the presumption should stand according to the command that government cannot force "some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."[50] They argue that the particular facts of this case weigh against aggregation. Particularly, the two parcels were never treated as one economic unit; they were acquired at different times for different purposes, and they were always used consistently with those separate purposes.[51]

In response, Wisconsin[52] relies heavily on the Supreme Court's typical deference to state property law. It contends that *Lucas* instructs that the relevant parcel should be defined by the property owner's "objectively reasonable expectations" as defined by state law.[53] Wisconsin notes that state law, not the Constitution, creates property rights.[54] Thus, it argues that deference to a state's choice of lot lines—in this case, the St. Croix County Ordinance—is strongly favored by Supreme Court precedent.[55] Wisconsin says this is particularly true because the "creation, alteration and significance of lot lines is entirely a function of the law of the State where the land is located."[56]

In Wisconsin's view, if the Supreme Court considers the objectively reasonable expectations of the Murr siblings consistent with *Lucas*, the two contiguous parcels must be treated as one. Wisconsin says the Murr siblings were "charged with knowledge" that the Ordinance would come into effect if they brought the two parcels into common ownership.[57] Thus, when they brought the parcels into common ownership in 1995, they took title to just one parcel consisting of the two lots together.[58] Since the siblings were presumed to have known about the Ordinance, they could have no reasonable expectation that the two parcels would remain separate.

In response to the Murr siblings' reliance on the 1959 lot lines and their arguments distinguishing *Penn Central* and *Tahoe-Sierra* as segmentation cases, Wisconsin says the precise nature of those cases is irrelevant. What matters are the reasonable expectations created by state law.[59] That is why Wisconsin dismisses any concern that its position would lead to an absolute rule of aggregation of adjacent parcels. As the state argues, "where aggregation of contiguous, commonly owned property is contrary to 'reasonable expectations,' as 'shaped' by state law, such aggregation would indeed be inappropriate."[60] In Wisconsin's view, the outcome of the case does not turn on the application of any presumptions—against aggregation or otherwise. Instead, the state argues that the two lots should be treated as one because that was an objectively reasonable view of state property law at the time the lots came into common ownership.[61]

Finally, Wisconsin argues that even if the Court finds that some sort of multi-factor analysis is necessary, it should prevail. Tracking its reasonable expectations argument summarized above, the state first contends that the siblings could not have had any expectations of being able to develop the second lot, in light of the Ordinance.[62] The state further notes that the lots are contiguous, that the dates of acquisition are close enough in time that this factor should not help the Murrs, *and* that the Murr siblings have in fact treated the lots as one parcel because they have placed things like a propane tank and a volleyball court on the second parcel as part of its use as a family gathering place.[63] Wisconsin contends these considerations should support aggregation in the event the Supreme Court finds them relevant.

In reply, the Murrs strongly dispute Wisconsin's version of the *Lucas* "reasonable expectations as shaped by state law" standard. While Wisconsin presses the idea that the Ordinance

46 Ark. Game & Fish Comm'n v. United States, 133 S. Ct. 511, 518 (2012).

47 Brief for Petitioner at 27-29, *Murr*, 136 S. Ct. 890.

48 *Lucas*, 505 U.S. at 1016 n.7.

49 Brief for Petitioner at 28-29, *Murr*, 136 S. Ct. 890.

50 Armstrong v. United States, 364 U.S. 40, 49 (1960).

51 Brief for Petitioner at 30, *Murr*, 136 S. Ct. 890.

52 Both the State of Wisconsin and St. Croix County are Respondents in the case, but I focus here on the State of Wisconsin's brief for reasons of clarity, brevity, and avoidance of repetition.

53 Brief for Respondent State of Wisconsin at 27-37, *Murr*, 136 S. Ct. 890.

54 *Id.* at 30 (citing Bd. of Regents v. Roth, 408 U.S. 564, 577 (1972)).

55 *Id.* at 31.

56 *Id.* at 33 (citing Oregon ex rel. State Land Bd. v. Corvallis Sand & Gravel Co., 429 U.S. 363, 378-81 (1977)).

57 *Id.* at 37-38.

58 *Id.*

59 *Id.* at 39-40.

60 *Id.* at 40.

61 The state actually posits an opposing hypothetical, arguing that under the Murrs' theory, enterprising property owners could obtain a windfall from state governments by voluntarily triggering a merger provision and then pressing a regulatory takings claim. *Id.* at 43. While it could be the case that some sophisticated investors might try this, it seems unlikely that average property owners like the Murr siblings would voluntarily invest in a takings lawsuit.

62 *Id.* at 44.

63 *Id.* at 45-47.

purporting to merge the two parcels is part of the relevant law that shapes property owners' expectations, the Murr siblings contend that the state misreads *Lucas*.[64] Instead, the relevant part of state law is "whether and to what degree the State's law has accorded legal recognition and protection to *the particular interest in land* with respect to which the takings claimant alleges a diminution in (or elimination of) value."[65] In *Lucas* itself, the "interest in land" at stake was the fee simple, "an estate with a rich tradition of protection at common law."[66] The Murrs contend that because the same is true here, the state law the Court should refer to is the original boundary lines that created the parcels in 1959 and define the nature of the fee simple estates.[67]

The Murrs also reject any characterization of the Ordinance as a "merger ordinance," precisely because it did not and could not alter those 1959 property lines.[68] To do that, a new certified survey map would have had to be created under the procedure established by Wisconsin law.[69] Because the Ordinance effected no recorded change to the survey map, the Murrs contend that it is merely a zoning measure that prohibits certain land use (in this case the development or sale of the second Murr lot).[70] In support of this, the siblings note that their parents actually owned both parcels between 1982 and 1994 before conveying the cabin parcel to the siblings and retaining the investment parcel.[71] If the lots had actually been merged, the parcels could not have been sold separately at that point.

As a result, the Murrs contend that the use restrictions in the Ordinance cannot define their property interests for the purposes of a takings claim. Instead, the proper place to look for background principles of state property law is "to antecedent understandings outside of the challenged regulations."[72] The Supreme Court confirmed this in *Palazzolo v. Rhode Island*, explicitly rejecting the argument that "by prospective legislation the State can shape and define property rights and reasonable investment-backed expectations, and subsequent owners cannot claim any injury from lost value."[73] The fact that property owners took title with notice of the regulation does not extinguish liability; "future generations, too, have a right to challenge unreasonable limitations on the use and value of land."[74] Under these principles, the Murr siblings say they should have the same right to challenge the limitations at issue that their parents would have had in 1975.

64 Reply brief at 5-6, *Murr*, 136 S. Ct. 890.

65 *Id.* at 6 (quoting *Lucas*, 505 U.S. at 1016 n.7).

66 *Lucas*, 505 U.S. at 1016 n.7.

67 Reply brief at 6, *Murr*, 136 S. Ct. 890.

68 *Id.* at 7.

69 *See id.* at 8 (describing the procedure).

70 *Id.* at 8-9.

71 *Id.* at 10.

72 *Id.* at 12.

73 533 U.S. 606, 626 (2001).

74 *Id.* at 626-27.

IV. Conclusion and Potential Implications

After years of uncertainty, the Supreme Court will finally throw its hat in the ring and attempt to answer the "relevant parcel" question this fall. As with most cases, *Murr* presents a specific factual situation that may not be all that common. But the Court at least seems likely to offer the lower courts important guidance on when, if ever, aggregation of contiguous, commonly owned parcels for takings purposes is appropriate. This answer will shape how property owners and local governments deal with each other and how those governments choose to apply zoning ordinances when all use of one adjoining parcel would be eliminated.

The Court is likely to address whether the existence of the St. Croix County Ordinance stripped the Murr siblings of any reasonable expectations of developing or selling the investment parcel. Under Wisconsin's argument, the presence of the Ordinance means the siblings never could have had such expectations. But the Murrs counter with the strong tradition of protection afforded to the fee simple estate and the fact that the two parcels have never been merged under the proper state procedures. Which of these the Court accepts will determine the scope of the "background principles" of state property law relevant to the parcel question.

If the Court agrees with the Murrs that the state lot lines that determine the fee simple interests in the two parcels are the relevant background principles, then it must decide whether to establish the presumption that the Murrs seek. The presumption—that separate legal parcels should be treated separately for takings purposes—should follow from *Lucas*' recognition that the fee simple is "an estate with a rich tradition of protection at common law"[75] and *Tahoe-Sierra*'s observation that the parcel as a whole is defined by "the metes and bounds that describe [a property's] geographic dimensions."[76] The Murrs believe they have the right facts to win if such a presumption is applied in this case, with the long separate ownership and differing purposes of the two parcels.

The recent Roberts Court's preference for narrow, fact-specific decisions means that the extent of the eventual holding in this case—whether adopting a presumption in favor of the fee simple interest or not—is uncertain. But it offers property owners a chance to breathe some much-needed life into regulatory takings law by expanding the situations in which courts can apply *Lucas*' categorical rule instead of *Penn Central*'s multi-factor test. A victory for the Murrs would mean that government agencies would have to think twice before applying land-use ordinances in a way that would deny all use of one adjoining parcel. And it would re-establish the primacy of the lot lines as shown on survey maps, providing objective boundaries of property interests. In short, property owners and government agencies will be watching closely when the Supreme Court issues its decision in this case early next year.

75 *Lucas*, 505 U.S. at 1016 n.7.

76 *Tahoe-Sierra*, 535 U.S. at 331.

Final Agency Actions and Judicial Review: *United States Army Corps of Engineers v. Hawkes Co.*

By James S. Burling

Note from the Editor:

This article discusses the Supreme Court's recent decision in *United States Army Corps of Engineers v. Hawkes Co.*, 136 S. Ct. 1807 (2016) and forecasts possible implications of the decision.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the authors. Whenever we publish an article that advocates for a particular position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article. We also invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

• Brief for Amicus Curiae Natural Resources Defense Council in Support of Respondent, Sackett v. Environmental Protection Agency, 566 U.S. __ (2012) (No. 10-1062), *available at* https://www.nrdc.org/sites/default/files/media-uploads/nrdc_sackett_brief_with_motion.pdf.

• Larry Levine, *David vs. Goliath -- or Goliath vs. David? Supreme Court to Hear Industry-Backed Challenge to Clean Water Enforcement*, NRDC Expert Blog (January 6, 2012), *available at* https://www.nrdc.org/experts/larry-levine/david-vs-goliath-or-goliath-vs-david-supreme-court-hear-industry-backed.

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Introduction: Wetlands and Administrative Actions

Two unanimous wetlands-related decisions from the Supreme Court could signal a change in attitude towards what heretofore has been a regime of extreme judicial deference towards agency decision-making. These decisions may or may not affect the substantive issues at hand—whether particular parcels of property contain jurisdictional wetlands—nor do they address what level of deference an agency should be accorded when a landowner challenges a wetlands determination. But they do allow landowners to have the substantive issues heard in court *before* facing ruinous delays, permitting costs, fines, and incarceration. More importantly, these cases—and some others—may reflect an impatience with the predilection of federal agencies and the Department of Justice to force ordinary citizens into Kafkaesque nightmares made real by the administrative state.

Regulatory restrictions and administrative procedures may appear to be divinely inspired to some, benign to others, and necessary evils to still others—at least where the targets of the regulatory commands are large, faceless corporate entities. To such entities, with armies of compliance officers and attorneys, the cost of the administrative state is the cost of doing business, offset by the decreased competition from smaller outfits unable to help write the rules and unwilling to contend with a multitude of new offices and swarms of officers. But where the same regulatory zeal is applied with equal force to ordinary citizens such as homeowners and small business owners, the courts are beginning to understand that something is amiss.

Sackett v. Environmental Protection Agency brought this lesson home when the Court held in favor of a small contractor and his wife who were attempting to build their modest family home in a residential neighborhood.[1] The details of the case have been laid out elsewhere,[2] but it should suffice to say that the Court was appalled by the plight of the couple being threatened with a compliance order replete with fines of $75,000 per day.[3] It took many years for the Court to recognize the problem here; indeed as late as three weeks before taking up the Sacketts' case, it turned away a petition for certiorari by General Electric on a nearly identical issue.[4] The EPA's application of essentially the same process and

1 566 U.S. __, 132 S. Ct. 1367 (2012).

2 *See, e.g.*, Damien Schiff, Sackett v. Environmental Protection Agency: *Compliance Orders and the Right of Judicial Review*, 13 Engage 2 (July 2012), *available at* http://www.fed-soc.org/publications/detail/sackett-v-environmental-protection-agency-compliance-orders-and-the-right-of-judicial-review.

3 Or, as Justice Alito remarked at oral argument, "don't you think most ordinary homeowners would say this kind of thing can't happen in the United States?" Sackett v. United States Environmental Protection Agency, No. 10-1062, 2012 WL 38639, at *37 (U.S. Oral. Arg., Jan. 9, 2012), *available at* https://www.supremecourt.gov/oral_arguments/argument_transcripts/10-1062.pdf.

4 *See* General Electric Company v. Jackson, *cert. denied*, 563 U.S. 1032 (2011). At issue was whether a "unilateral administrative order" was justiciable, noting the threat of huge fines for noncompliance. General Electric noted in its petition that in the preceding decade EPA had issued over 1,700 such orders to 5,400 companies with total compliance costs exceeding $5 billion. A copy of General Electric's petition can be found at http://sblog.s3.amazonaws.com/wp-content/uploads/2011/04/10-871.pdf.

attitude towards the Sacketts as it had displayed towards corporate players like GE led to the ultimate demise of the practice of issuing compliance orders unchecked by judicial review.

In *Sackett*, the would-be homeowners had begun the process of developing a small lot for their home when the EPA paid them a visit and told them to stop because they were filling a wetland.[5] They received a compliance order telling them to remove the fill, plant wetlands vegetation, wait three years, and then apply for an after-the-fact permit to regularize the allegedly illegal fill (which would have been removed). If they failed to comply, they would face fines of up to $75,000 per day. The Sacketts, however, consulted a former Corps wetlands scientist and concluded that there were not wetlands on their lot, so they appealed. They lost at the trial court and the Ninth Circuit, both of which concluded that compliance orders were not "final agency actions" under the Administrative Procedure Act (APA)[6] and, therefore, not justiciable.[7] The Supreme Court unanimously reversed.

Few Americans receive EPA compliance orders that will hang over them like the sword of Damocles until they cave and do the EPA's bidding. But many more people—just about anyone who owns any undeveloped land—are concerned about whether the use of a parcel of property is affected by the presence of wetlands. Indeed, under the EPA's new proposed "Waters of the United States" or WOTUS rule, the amount of acreage potentially covered by the rule could rise dramatically. In 2006, the Supreme Court noted that there are between 270 and 300 million acres of wetlands, a figure that could be merely the baseline under the proposed rule.[8]

I. United States Army Corps of Engineers v. Hawkes Co.[9]

The Hawkes Company, which is in the business of harvesting peat moss in northern Minnesota, disagreed with a Corps "jurisdictional determination" (JD) that concluded that wetlands on Hawkes' property were subject to federal jurisdiction. Hawkes argued that its property had no connection to interstate commerce, and noted that the closest navigable waterway was 120 miles away.[10] Hawkes won an administrative appeal, but on remand the Corps' district engineer perfunctorily reinstated the jurisdictional determination.[11]

At that point, the Corps told Hawkes that it had three options. First, Hawkes could abandon its peat mining plans. Second, the company could apply for a permit that would cost several hundred thousand dollars and several years of its time. This was after a Corps bureaucrat said the agency would never issue a permit, and even kindly advised a long-term Hawkes employee to look for a new job. But, the Corps said, Hawkes could only challenge the wetlands JD after trying to get a permit, which it hinted would inevitably be denied.[12] The third choice was to harvest the peat anyway and hope for the best in the inevitable civil and criminal enforcement action—risking fines of at least $37,500 per day plus considerable time in a federal prison.[13] Hawkes appealed the JD to the federal district court in Minnesota.[14]

Following the logic of the Ninth Circuit's decision in *Fairbanks North Star Borough v. United States Army Corps of Engineers*,[15] the trial court found that the JD did not constitute final agency action justiciable under Section 704 of the Administrative Procedure Act.[16] The Eighth Circuit reversed, holding:

> The prohibitive costs, risk, and delay of these alternatives to immediate judicial review evidence a transparently obvious litigation strategy: by leaving appellants with no immediate judicial review and no adequate alternative remedy, the Corps will achieve the result its local officers desire, abandonment of the peat mining project, without having to test . . . its expansive assertion of jurisdiction . . . .[17]

The United States petitioned for and was granted certiorari, essentially arguing that JDs have no legal consequences because it is the Clean Water Act that defines jurisdiction, not the JDs themselves. Instead, JDs are merely "helpful" to landowners. The Court did not agree. In an opinion written by Chief Justice Roberts, all eight Justices agreed that landowners have the right to challenge JDs in court. This ends a practice of more than 40 years where the Corps has been issuing JDs and courts have been denying landowners the right to challenge them in court.[18]

While the Court has rebuffed the Corps' attempts to unduly expand its jurisdiction in some cases, it has only done so where an entity or an individual was defending against an enforcement action, and where there was a threat of massive fines or worse. Thus the Corps had been rebuffed when it tried to expand its

5 132 S. Ct. at 1370-71.

6 5 U.S.C. § 704.

7 *Sackett*, 132 S. Ct. at 1371.

8 *Compare* Rapanos v. United States, 547 U.S. 715, 722 (2006) (270-300 million acres), *with* statements by the American Farm Bureau Federation, "How WOTUS Will Affect Farmers", http://www.fb.org/issues/wotus/resources/ (last visited Aug. 23, 2016) ("will radically expand federal jurisdiction"), *and* Environmental Protection Agency, *Facts About the Waters of the U.S. Proposal*, https://www.epa.gov/sites/production/files/2014-09/documents/facts_about_wotus.pdf (last visited Aug. 23, 2016) ("NOT dramatically expanding jurisdiction."). The text of the WOTUS rule can be found at https://www.epa.gov/sites/production/files/2015-06/_documents/preamble_rule_web_version.pdf (last visited Aug. 23, 2016). The rule is presently subject to numerous challenges.

9 __ U.S. __, 136 S. Ct. 1807 (2016).

10 *Id.* at 1810.

11 *Id.* at 1813.

12 *See* Respondent's brief in United States Army Corps of Engineers v. Hawkes Co, Inc., 2016 WL 750545 (U.S.), 10 (U.S., 2016).

13 Hawkes Co., Inc. v. United States Army Corps of Engineers, 782 F.3d 994, 1001-02 (8th Cir. 2015) (discussing alternatives); *Hawkes*, 136 S.Ct. at 1815 (noting fines and alternatives).

14 136 S.Ct. at 1812.

15 543 F.3d 6 (9th Cir. 2008). In *Fairbanks* the borough had sought to build a playground on permafrost wetlands and disputed that the wetlands were within the jurisdiction of the Corps. The Ninth Circuit found that the JD was not appealable under the Administrative Procedure Act.

16 Hawkes Co. v. U.S. Army Corps of Engineers, 963 F. Supp. 2d 868 (D. Minn. 2013).

17 *Hawkes*, 782 F.3d at 1001-02.

18 *See, e.g.*, Hoffman Group, Inc. v. Environmental Protection Agency, 902 F.2d 567, 568 (7th Cir. 1990) (finding of jurisdictional wetlands not justiciable outside permit or enforcement process).

each into isolated ponds because they were visited by ducks,[19] into dry farmland,[20] into vast expanses of permafrost wetlands in Alaska,[21] and into usually dry desert arroyos. But these were only in cases where landowners were facing severe penalties and had standing to challenge JDs as defendants.[22] In the vast majority of cases where the Corps has asserted unwarranted jurisdiction, as alleged in *Hawkes*, the courts have been unable or unwilling to intercede because of a purported lack of a final agency action subject to judicial review. That changed in *Hawkes*.

There were two bases for the decision. The first, which a concurring Justice Kagan would have found "central," was predicated on a Memorandum of Agreement (MOA) entered into between the Corps and the EPA in which each agency agreed to be bound by jurisdictional determinations of the other.[23] Thus, if the Corps issued a "negative JD," a finding of *no* wetlands, it would bind both agencies. The Court reasoned that, since a negative JD's safe harbor was clearly of legal consequence, so too was a positive JD as in *Hawkes*.[24]

The second, and more far-reaching, rationale was based on *Abbott Labs. v. Gardner*[25] and *Frozen Food Express v. United States*,[26] in which the Court previously held that a citizen need not risk severe penalties in order to challenge a final administrative action under the APA. Similarly, in *Bennett v. Spear*[27] the Court noted that a final agency action ought to have "legal consequences" before it is justiciable. In *Hawkes*, the Court found that in accordance with *Abbott Labs.*, *Frozen Foods*, and *Bennett*, when there are no adequate alternatives available, then the agency action may well be final and justiciable.[28] The *Hawkes* Court reiterated its holding from *Sackett* that citizens "need not assume such risks while waiting for the EPA 'to drop the hammer.'"[29]

In response to the government's argument that the permitting process provided all the process the law required, the Court found that the process was "arduous, expensive and long," and cited a long list of information the Corps demanded from Hawkes—from a "hydrogeological assessment of the rich fen system" to groundwater pH studies to an inventory of vegetation "in the area."[30] But as the Court noted, not only was gathering this information quite burdensome, but all of the demanded information merely described the nature of the wetlands in question. That might be relevant to whether a permit should be granted, but it is not relevant to the legal questions of finality and judicial review.[31]

Lastly, the majority opinion addressed the Corps' suggestion that it was doing landowners a favor because the Clean Water Act did not mandate the issuance of JDs. Reflecting Justice Roberts' penchant for one-liners, the Court rejected the notion of a "count your blessings" exception to the Administrative Procedure Act.[32]

II. Implications for WOTUS?

The Court has previously noted the broad reach of the Clean Water Act's wetlands rules and the difficulty that landowners have in determining what is and what is not a wetland.[33] There is some indication in *Hawkes* that the patience of at least some of the Justices is wearing thin. At oral argument, the United States indicated that, if the Court were to base its opinion on the memorandum of understanding between the Corps and the EPA, then it might simply rescind that agreement.[34] This led to a rejoinder by Justice Kennedy that "the Clean Water Act is unique in both being quite vague in its reach, *arguably unconstitutionally vague*, and certainly harsh in the civil and criminal sanctions it puts into practice."[35]

Now, in a concurrence in *Hawkes*, writing for himself and Justices Alito and Thomas, Kennedy opined that:

> [t]he Act, especially without the JD procedure were the Government permitted to foreclose it, continues to raise troubling questions regarding the Government's power to cast doubt on the full use and enjoyment of private property throughout the Nation.[36]

If anything, this could well portend judicial skepticism of the WOTUS rule, which is currently stayed and subject to numerous legal challenges.[37]

While defenders of property rights are obviously pleased by the *Hawkes* decision, it does not solve landowners' problems; it

19 *See, e.g.*, Solid Waste Agency of Northern Cook County v. United States Army Corps of Engineers, 531 U.S. 159 (2001) (striking down migratory bird rule).

20 *Rapanos*, 547 U.S. at 722.

21 *See, e.g.*, *Fairbanks North Star Borough*, 543 F.3d 586.

22 *See, e.g.*, *Rapanos*, 547 U.S. 715.

23 *Hawkes*, 136 S. Ct. at 1817 (Kagan, J., concurring.)

24 Notably, Justice Ginsburg issued a separate concurrence specifically taking issue with Justice Kagan's opinion that the MOA was controlling and with any reliance upon the MOA by the Court. *Id.* at 1817-18 (Ginsburg, J., concurring.)

25 387 U.S. 136 (1967) (holding that drug labeling regulations were justiciable because of the serious penalties for noncompliance).

26 351 U.S. 40 (1956) (Interstate Commerce Commission listing of commodities as either subject to or exempt from the statute was a final agency action subject to judicial review).

27 520 U.S. 154 (1997) (ranchers and irrigation districts had right to challenge agency action concerning the Endangered Species Act).

28 136 S. Ct. at 1815.

29 *Id.* (citing *Sackett*, 132 S. Ct. at 1372).

30 *Id.* at 1816.

31 136 S.Ct. at 1816 ("And whatever pertinence all this might have to the issuance of a permit, none of it will alter the finality of the approved JD, or affect its suitability for judicial review. The permitting process adds nothing to the JD.").

32 *Id.* ("True enough. But such a 'count your blessings' argument is not an adequate rejoinder to the assertion of a right to judicial review under the APA.").

33 *See, e.g.*, *Rapanos*, 547 U.S. 715 and *Sackett*, 132 S. Ct. 1367.

34 No. 15-290, 2016 WL 1243207, at *16 (U.S. Oral. Arg., Mar. 30 2016).

35 *Id.* at *18 (emphasis added). This is ironic considering Justice Kennedy authored the "significant nexus" concurrence in *Rapanos*, 547 U.S. at 742, a test that itself is fraught with ambiguity.

36 136 S. Ct. at 1817.

37 *See, e.g.*, Julio Columba, *PLF files brief on jurisdiction of Waters of the United States rule challenges*, Liberty Blog (July 11, 2016), *available at* http://blog.pacificlegal.org/42296-2/.

merely gives them an avenue for a neutral decision maker to rule on whether a property is subject to federal jurisdiction. The case does not help define what wetlands are, and judicial review of the intensely factual questions of wetlands definition and jurisdiction will likely prove to be "arduous, expensive and long."[38] Thus, the overarching conflict between landowners and the enforcement of wetlands regulations remains. If Congress does not reform the Clean Water Act, then the Court is going to have to limit its application in order to preserve its constitutionality. The *Sackett* and *Hawkes* decisions are steps in that direction.

III. Postscript

It should be noted that the import of the *Hawkes* decision will not be confined to wetlands. Already it has been relied upon in other questions of the justiciability of final agency actions outside the context of the Clean Water Act. Thus in *Rhea Lana, Inc. v. Department of Labor*,[39] issued *four days* after the Supreme Court decided *Hawkes*, a Department of Labor "advisory letter" sent to an employer regarding back wages was found justiciable because, like the *Hawkes* JD, it had "'direct and appreciable legal consequences' on potential liability that count for purposes of finality."[40] In *Texas v. Equal Employment Opportunity Commission*,[41] the court found justiciable a guidance document on disparate impact issued by the Equal Employment Opportunity Commission. Cases arising out of actions involving the Department of Transportation,[42] the Railroad Retirement Board, and the Social Security Administration had similar results.[43] And, most recently, a federal district court found that the Obama administration's bathroom policy for transgender students was a final agency action based on *Hawkes*.[44] Hawkes should be seen as an administrative law decision in the broadest sense—affecting all federal agencies across the wide spectrum of their activities throughout this country. It is much more than a mere wetlands case. Judging from these early returns, it is likely that its impact will reverberate throughout administrative law for a long time.

38 *Hawkes*, 136 S.Ct. at 1815. As of September 6, 2016, the remand of the Sacketts' challenge to the EPA's assertion of jurisdiction remains mired in federal district court.

39 Case No. 15-5014, 824 F.3d 1023, 2016 WL 3125035 (D.C. Cir. June 3, 2016).

40 *Id.* at *6 (internal citation omitted). Another Department of Labor action found justiciable based on *Hawkes* was *Berry v. United States Dep't of Labor*, No. 15-6316, 2016 WL 4245459 (6th Cir. Aug. 11, 2016) (refusal to reopen his claim for workers' compensation benefits under Energy Employees Occupational Illness Compensation Program Act based on new evidence).

41 Case No. 14-10949, ___ F. 3d ___, 2016 WL 3524242 (5th Cir. June 27, 2016).

42 Southwest Airlines Co. v. United States Dep't of Transp., No. 15-1036, __ F.3d __, 2016 WL 4191190, at *4 (D.C. Cir. Aug. 9, 2016) (noting that the Supreme Court in *Hawkes* "looked to the way in which the agency subsequently treats the challenged action").

43 Stovic v. R.R. Ret. Bd., No. 14-1251, 2016 WL 3457645, at *2 (D.C. Cir. June 24, 2016).

44 Texas v. United States, N.D. Tex. Case No. 7:16-cv-00054-0, Preliminary Injunction Order, Aug. 21, 2016, at 17.

The Sandbagging Phenomenon: How Governments Lower Eminent Domain Appraisals to Punish Landowners

By C. Jarrett Dieterle

Note from the Editor:

This article discusses a controversial practice known as "sandbagging" in eminent domain proceedings. The article describes and criticizes the practice, then suggests ways in which courts and legislatures might seek to curb its use.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. Whenever we publish an article that advocates for a particular position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article. We also invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

• Katrina Miriam Wyman, *The Measure of Just Compensation*, 41 U.C. Davis L. Rev. 239 (2007), http://lawreview.law.ucdavis.edu/issues/41/1/articles/davisvol41no1_wyman.pdf.

• Nicole Stelle Garnett, *The Neglected Political Economy of Eminent Domain*, 105 Mich. L. Rev. 102 (2006), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=875412.

• Steve Calandrillo, *Eminent Domain Economics: Should 'Just Compensation' Be Abolished, and Would 'Takings Insurance' Work Instead?*, 64 Ohio St. L.J. 451 (2003), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=693042.

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Government is instituted to protect property of every sort . . . [t]his being the end of government, that alone is a just government, which impartially secures to every man, whatever is his own.

– James Madison[1]

Introduction

The landmark 2005 Supreme Court case of *Kelo v. New London* sparked a wave of eminent domain reform across the United States.[2] Given the focus of *Kelo*, most of these reforms concerned the "public use" prong of the Fifth Amendment's Takings Clause. The legal community's post-*Kelo* focus, however, may have (understandably) diverted attention away from the second prong of the Takings Clause—"just compensation"—and how it is equally ripe for governmental abuse. This focus on only one prong of the Takings Clause should be resisted; as one scholar has put it, the "current inadequacy" of the public use requirement in the aftermath of *Kelo* "compels attention to the just compensation limitation to protect property rights."[3]

Governments today are often as likely to undermine their citizens' property rights by systematic undercompensation as by elastic definitions of what constitutes a proper "public use." There has been a noticeable trend in local and state governments around the country "sandbagging" or "lowballing"[4] property owners whose property they take, which results in landowners being denied proper compensation for land seized via eminent domain. Sandbagging occurs when a government decides it wants to seize a certain parcel of land pursuant to its eminent domain powers and arranges for an appraisal to determine the land's worth. The government will then make the landowners a pre-condemnation offer based on this first appraisal. If these negotiations fail, the government institutes an eminent domain proceeding to force the sale of the land. But once the case goes to trial, the government pulls a bait-and-switch and uses a second, lower appraisal as its evidence of the land's value.

The result is that landowners face a no-win situation. If they believe the government's initial offer is too low, they not only face the prospect of litigation (with its attendant costs), but they risk the government attempting to punish them by lowering the appraisal later in the process. In other words, governments attempt to dissuade landowners from holding out for more compensation by punishing those that do so, which results in governments getting away with systematic undercompensation in eminent domain proceedings. In essence, a sandbagging government says to landowners, "if you think our

1 James Madison, Property, *The Writings of James Madison*, ed. Gaillard Hunt (1900), Vol. 6, at 101-102, http://oll.libertyfund.org/titles/1941#Madison_1356-06_476.

2 *See* Ilya Somin, *The political and judicial reaction to* Kelo, The Volokh Conspiracy (June 4, 2015), https://www.washingtonpost.com/news/volokh-conspiracy/wp/2015/06/04/the-political-and-judicial-reaction-to-kelo/?utm_term=.e9101e59e44f.

3 *See* Danielle B. Ridgely, *Will Virginia's New Eminent Domain Amendment Protect Private Property?*, 26 Regent U. L. Rev. 297, 320 (2014).

4 *See* A. Barton Hinkle, *Theft-by-Government Continues Through Eminent Domain*, Reason (Jan. 27, 2016), http://reason.com/archives/2016/01/27/theft-by-government-continues-through-em.

initial appraisal is too low, just see how low we'll go if you take it to court!"

The sandbagging phenomenon has started to receive more exposure in popular media,[5] as commentators have recognized that a government that systematically undercompensates landowners is a government that is failing to protect the basic property rights of its citizens. This article analyzes the sandbagging phenomenon and points out substantive reforms that could be implemented to guard against the practice. The article starts by briefly explaining the doctrinal underpinnings of the Just Compensation Clause of the Fifth Amendment, the rationales for compensating landowners for property taken pursuant to eminent domain, and the prevalence of undercompensation. Then, it discusses the specific phenomenon of sandbagging through case law, scholarly articles, and news reports. Finally, it addresses why sandbagging is so problematic and suggests possible ways to prevent it.

I. Background on Just Compensation

A. Historical and Doctrinal Roots of Just Compensation

Local governments in America started using the power of eminent domain in the pre-Revolutionary colonial era, often for the purpose of building public roads or buildings.[6] While "[n]o colonial charter expressly required compensation," when land was seized by the government, "compensation for takings 'was well established and extensively practiced.'"[7] The first form of a compensation clause appeared in the 1641 Massachusetts Body of Liberties, and just compensation clauses thereafter began to show up in state constitutions, and ultimately the U.S. Constitution.[8]

Over the years, the U.S. Supreme Court has held that just compensation is to be defined as the fair market value of a piece of property at the time of the taking.[9] Fair market value, in turn, has been defined as the amount a willing buyer and a willing seller would mutually agree to in a market transaction for the property at issue.[10] The generally recognized goal when determining a proper amount of compensation is to restore landowners to the same financial position that they were in prior to the taking of their land.[11] States have traditionally interpreted just compensation under state constitutions in the same way.

B. Rationales for Why Just Compensation Is Required When Land is Taken

A few of the many rationales for why just compensation is legally and morally required when the government takes property are worth summarizing here. Some justify such compensation based on notions of natural rights and the Lockean labor theory of property.[12] Locke theorized that there is a natural right to enjoy the fruits of one's own labor, and that property rights stem from that basic right. Thus, taking away property that was built or bought by a person's labor requires compensation; without it, the owner is deprived of that natural right.[13]

Just compensation has also been justified under a corrective justice theory, in which compensation can be viewed "as an attempt to make the victim [the property owner] whole" after the government has interfered with the owner's property rights.[14] Compensation can be viewed through a more utilitarian lens, as well—*i.e.*, as a mechanism to encourage investment in property by providing a backstop if that property is later seized pursuant to eminent domain.[15] This backstop can be particularly helpful in encouraging investment by more risk-averse, less wealthy individuals who might be concerned about a highway being re-routed through a piece of land they are considering for purchase.

Finally, the compensation requirement can constrain the government's exercise of its eminent domain powers. Under this framework, the compensation requirement can be likened to tort liability in that it forces the government to "internalize" and "bear the costs" of its eminent domain decisions.[16] This cost-internalization requires governments to exercise prudence when making decisions about what property to seize via eminent domain.[17] Budget constraints work to limit the amount of property that governments can take insofar as each taking requires a corresponding amount of compensation; therefore governments are "motivate[d] to make efficient decisions" about how much property they should take.[18]

Each of these rationales for just compensation is undermined when governments systematically undercompensate property owners via tactics like "sandbagging." Landowners are

5 *See id.*; Editorial, *Sandbagging, exposed*, Richmond Times-Dispatch (Apr. 19, 2015), http://www.richmond.com/opinion/our-opinion/article_c05a855f-dcbc-5394-9a2e-ad2b4040a46f.html; Jason Marks, *Landowners accuse VDOT of scam*, WAVY.com (Feb. 10, 2014), http://wavy.com/2014/02/10/landowners-accuse-vdot-of-scam/.

6 *See* Ridgely, *supra* note 3, at 302–3.

7 *Id.* at 303.

8 *Id.*

9 *See* Olson v. United States, 292 U.S. 246, 255 (1934) ("[T]he market value of the property at the time of the taking contemporaneously paid in money. . . . Just compensation includes all elements of value that inhere in the property, but it does not exceed market value fairly determined.").

10 *See* United States v. Miller, 317 U.S. 369, 374 (1943) ("It is usually said that market value is what a willing buyer would pay in cash to a willing seller.").

11 *Id.* at 373.

12 *See* Steve P. Calandrillo, *Eminent Domain Economics: Should "Just Compensation" Be Abolished, and Would "Takings Insurance" Work Instead?*, 64 Ohio St. L.J. 451, 489 (2003).

13 *Id.*

14 Katrina Miriam Wyman, *The Measure of Just Compensation*, 41 U.C. Davis L. Rev. 239, 249 (2007); *see also* Calandrillo, *supra* note 12, at 489.

15 *See* Calandrillo, *supra* note 12, at 490-91.

16 *See* Wyman, *supra* note 14, at 246.

17 *Id.*

18 *Id.*; *see also* Calandrillo, *supra* note 12, at 491. Some scholars have cast doubt on this incentive effect. *See* Wyman, *supra* note 14, at 246-48 (noting that governments are often motivated more by political than economic factors and that taxpayers rather than government officials are actually the entities that ultimately pay for any taken property).

deprived of their rights, they are not made whole, investors are uneasy, and governments have less reason to exercise restraint in the use of their eminent domain powers.

C. The Prevalence of Undercompensation

The fair market value standard for just compensation may seem straightforward and sufficient for ensuring that property owners are properly compensated when their property is taken, but lawyers and commentators have long recognized that undercompensation is common even where legal requirements are met.[19]

The main theoretical complaint about the fair market value metric for compensation is that it overlooks many factors that are important in the average property transaction. For one, fair market value routinely ignores factors that individual sellers would consider in an actual voluntary transaction.[20] A family that places extra sentimental value on its family farm, for example, would presumably demand a premium above mere market value in order to part with it. Under the fair market value standard, however, the government merely pays for what it has acquired, not what the owner has lost.[21] Another factor that might be considered in a true market transaction, but that often goes unaddressed in eminent domain sales, is the future value and income that the property might generate.[22] Landowners who lose their property to eminent domain have no chance to reap the benefits of any lucrative future uses of their property.

Fair market value also fails to compensate for more basic costs that landowners incur when they are forced to give up their property. Landowners are not compensated for losses arising from moving expenses, attempts to acquire a new piece of property to replace the old one, or the loss of value a relocated business suffers after being forced to move.[23] And last but definitely not least, landowners who go through eminent domain proceedings must cover any attorney and expert fees that are required for contesting the taking.[24]

While undercompensation can occur at any stage of eminent domain proceedings, it is particularly prevalent in the pre-condemnation stage.[25] Again, pre-condemnation offers are often used by governments to induce landowners to voluntarily sell their property without the hassle of instituting an actual condemnation proceeding. Undercompensation in the pre-condemnation setting is common for several reasons. First, landowners often assume that the government is generally honest and would not attempt to shortchange them for their property, which often makes them willing to simply accept the government's first offer for their land. Second, even if property owners suspect that a pre-condemnation offer might be inadequate, they view any attempts to fight back against the government as futile. Third, property owners frequently decide that contesting a taking is not worth the effort and expense (condemnation lawyers often suggest that litigation contesting undercompensation is not economically feasible unless the spread between the offer and the true value of the property is at least $75,000).[26] Finally, many landowners are upset about losing their property and want to take a quick offer and get on with their lives.[27]

II. The Sandbagging Phenomenon

A. How Sandbagging Happens

Sandbagging happens when a condemning authority appraises a property slated for condemnation—often as the basis for a pre-condemnation offer to purchase the property—only to later *lower* the appraisal estimate if the landowner refuses to accept the condemning authority's initial offer. This is usually done by commissioning two appraisals—a higher appraisal that is used as the basis for the initial offer, and then a lower appraisal for use in an actual condemnation proceeding.

Sandbagging is often—though not always[28]—facilitated by a process known as "quick-take," under which local and state governments (if authorized under state law) can seize a landowner's property immediately.[29] This accelerated process allows the condemning authority to enter the property and start its project before condemnation proceedings are formally instituted, which can be important for time-sensitive government projects that cannot wait several years for an eminent domain case to reach its conclusion. In most quick-take situations, if the landowner refuses the government's initial offer, the government will file a certificate of take with the local court where the land is located, as well as a deposit equal to the government's estimate of the property's value. The condemning authority is then

19 Empirical research has also provided some evidence that could back up concerns that undercompensation is prevalent. *See generally* Yun-Chien Chang, *An Empirical Study of Compensation Paid in Eminent Domain Settlements: New York City 1990-2002*, Law & Economics Research Paper Series Working Paper No. 08-52 (Nov. 2008), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1120072.

20 *See* Gideon Kanner, *[Un]Equal Justice under Law: The Invidiously Disparate Treatment of American Property Owners in Taking Cases*, 40 Loy. L.A. L. Rev. 1065, 1088 (2007); Brian Angelo Lee, *Just Undercompensation: The Idiosyncratic Premium in Eminent Domain*, 113 Colum. L. Rev. 593, 595 (2013); Wyman, *supra* note 14, at 255.

21 *See* Kanner, *supra* note 20, at 1088.

22 *See* Wyman, *supra* note 14, at 255.

23 *Id.* at 254; Kanner, *supra* note 20, at 1093.

24 Wyman, *supra* note 14, at 254; Kanner, *supra* note 20, at 1091.

25 Kanner, *supra* note 20, at 1105.

26 *Id.*

27 *See id.* for more on these pre-condemnation factors.

28 Sandbagging simply refers to a situation where a condemning authority values a parcel of property at a certain level, only to lower that valuation later in the eminent domain process. Thus it can happen in non-quick-take settings, as well. Quick-take, however, is particularly ripe for sandbagging.

29 *See, e.g.*, Va. Code § 33.2-1018; Henry Howell, III and Christi Cassel, *The Differences In "Quick-Take" And "Slow-Take" When Property is Condemned*, Waldo & Lyle, P.C., http://www.waldoandlyle.com/resources/waldo-and-lyle-articles/98-the-differences-in-qquick-takeq-and-qslow-takeq-when-property-is-condemned.

required to bring a timely condemnation proceeding against the property.[30]

In the meantime, the property owner can withdraw the deposited funds without compromising her ability to contest the amount of compensation that must be paid for the property during the later condemnation proceeding.[31] The property owner takes a risk in doing so, however, because if the value of the property is determined to be *less* than the amount the government initially deposited during the quick-take process, the landowner is on the hook for *repaying* the difference.[32] Such an outcome can put some types of property owners—such as small business owners who lose their storefront via quick-take and are forced to immediately withdraw the deposited funds in order to buy a new storefront for their business—in an impossible position. If they are later required to reimburse the government if the condemnation proceeding does not go their way, they may lack the liquid assets to do so.[33]

A government that lowers its appraisal of the property in question once a formal proceeding is commenced only increases the stakes for landowners who refuse an initial offer and decide to test their chances in court. In fact, knowledgeable practitioners in the area of condemnation have suggested that the purpose of sandbagging is "to coerce the [land]owner into accepting the pre-litigation offer on pain of running the risk of a verdict below that offer."[34]

Consider this representative example of sandbagging. In 2009, the Virginia Department of Transportation (VDOT) began trying to acquire a .387-acre parcel of land from James and Janet Ramsey in Virginia Beach using Virginia's quick-take process.[35] VDOT, which sought the property for the purpose of constructing an off-ramp for a state highway, ordered an appraisal of the parcel in question. The appraisal found the property to be worth about $246,000. The Ramseys, deciding that this amount was inadequate, refused to accept VDOT's initial offer, electing to hold out for a higher amount at trial. The government accordingly deposited the money as required under the quick-take process, and the Ramseys withdrew it and invested it. Once the case proceeded to court, however, VDOT hired a second appraiser, who testified that the property was only worth around $92,000. The Ramseys attempted to introduce evidence of the first appraisal in their condemnation proceeding, and they had to take their case all the way to the Virginia Supreme Court to establish their right to do so. That portion of their case will be discussed further below.[36]

B. The Prevalence of Sandbagging

The condemnation bar considers sandbagging a fairly common practice,[37] and examples of it have sprung up in New York and California and many places in between.[38] Law professor Gideon Kanner has even created a blog which, among other things, tracks instances of lowballing and sandbagging from around the country.[39]

Ultimately, it is hard to know the true extent of the problem. Many potential examples of it go unreported because landowners accept the government's first offer, even if they view it as inadequate.[40] This reduces the chance that a news reporter will cover a sandbagging story—a news agency is much more likely to cover a case like the Ramseys' that makes it all the way to the Virginia Supreme Court than a story about a landowner that

30 *See generally* Charles M. Lollar and Jeremy P. Hopkins, *Virginia Eminent Domain: Frequently Asked Questions*, Waldo & Lyle, P.C., http://pstrust.org/wp-content/uploads/2013/04/Virginia-Summary-2014.pdf.

31 *Id.*

32 *See* A. Barton Hinkle, *When Eminent Domain Is Just Theft*, Reason (Feb. 17, 2014), http://reason.com/archives/2014/02/17/when-eminent-domain-is-just-theft.

33 *Id.*

34 Gideon Kanner, *Sic Transit Gloria: The Rise and Fall of Mutuality of Discovery in California Eminent Domain Litigation*, 6 Loy. L.A. L. Rev. 447, 461 n.59 (1973).

35 For a full recitation of these facts, see *Ramsey v. Comm'r of Hwys*, 770 S.E.2d 487, 488-89 (Va. 2015); *see also* Hinkle, *supra* note 32.

36 For more discussion on the *Ramsey* case, see Section III.A. below.

37 *See* Kanner, *supra* note 34, at 461 n.59.

38 *See, e.g.*, *Ramsey*, 770 S.E.2d at 488-89 (first offer $246,000; lower to $92,000 at trial); City and County of San Fran. v. Convenience Retailers, No. CGC-11-507339 (2013) (first appraisal of $5 million; lowered to $3.125 million at trial after claiming $1.3 million needed to be deducted for remediation of site); Sacramento Area Flood Control Agency v. Souza, No. 34-2010-00083124 (2013) (first appraisal $330,000; lowered to $195,000 at trial); United States v. Harrell, 642 F.3d 907 (10th Cir. 2011) (first government valuation of a mineral interest was $700,000; government later adduced expert testifying interest was worth $185,500); Land Clearance for Redevelop. Auth. of St. Louis v. Henderson, No. 0622-CC05527 (Mo. Ct. App. Nov. 29, 2011) (initial government valuation of property was $562,500 minus clean-up costs; government's valuation evidence at trial lowered to $230,600 minus clean-up costs); Mich. Dept. of Transp. v. Frankenlust Lutheran, No. 03-003055-CC (Mich. Ct. App. 2006) (first offer $592,000; lowered to $409,000 at trial); CMRC Corp. v. New York, 270 A.D.2d 27 (N.Y. App. Div. 2000) (first offer $4.8 million; lowered to $3.6 million); Community Redevelopment Agency v. World Wide Enterprises, Inc., 77 Cal. App. 4th 1156 (Cal. Ct. App. 2000) (first offer just over $1 million; lowered to $810,000). *See also* Michael Rikon, *Supreme Court, Rockland County Agrees with Claimant's Highest & Best Use, Awards $741,671.00 in Just Compensation*, Bulldozers At Your Door (Mar. 6, 2015), http://eminent-domain-blog.com/supreme-court-rockland-county-agrees-claimants-highest-best-use-awards-741671-00-just-compensation-claimant/ (discussing the New York case of *Ferguson Management Company, LLC v. The Village of Haverstraw*, which involved a first offer of $575,000 that was lowered to $316,500 at trial), *and* Michael Rikon, *Appellate Division Affirms Award in AAA Electricians*, Bulldozers At Your Doorstep (Feb. 27, 2015), http://eminent-domain-blog.com/appellate-division-affirms-award-in-aaa-electricians/ (discussing the case of *Village of Haverstraw v. AAA Electricians, Inc.*, which involved a first offer of $3.4 million that was lowered to $1.5 million); Marks, *supra* note 5 (news investigation finding several examples of sandbagging in Virginia involving the VDOT, including a property appraisal in Virginia Beach that was dropped from $210,000 to $17,000; an offer in Prince William County that dropped from $214,000 to $14,000; and a property appraisal in Northern Virginia that was reduced from $3.9 million to $2.1 million); Hinkle, *supra* note 5 (describing a situation in Virginia where the first appraisal of $466,000 was reduced to $130,000).

39 *See generally Lowball Watch*, Gideon's Trumpet, http://gideonstrumpet.info/category/lowball-watch/.

40 *See* Kanner, *supra* note 20, at 1104-04 (noting that initial eminent domain offers "are frequently accepted by large numbers of property owners," often "in spite of their inadequacy"). For more on why landowners oftentimes accept offers that undercompensate them, see Section I.C.

reluctantly but willingly accepted the condemning authority's initial offer. The same goes for reported case law,[41] which cannot capture situations where no formal eminent domain proceeding occurred or where the dispute was settled out of court. Because of these factors, many situations in which governments engage in or threaten sandbagging tactics never make it into the public eye.

Despite the difficulty of empirically measuring the prevalence of sandbagging across the country, those most in tune with eminent domain law—practitioners in the field and academics who study it—believe that instances of sandbagging are common and on the rise. As one eminent domain attorney from Michigan noted, "a lot of the government agencies . . . across the country" are "lowering their offers to punish people for fighting them."[42] Other practitioners in the field have noted similar trends.[43]

The fact that sandbagging is common across the United States gives rise to real concerns about whether local and state governments are respecting and protecting Americans' property rights. One or two cases could be chalked up to a few "bad apple" local governments, but the wave of sandbagging cases around the country suggests that many governments are engaged in a systematic deprivation of the Fifth Amendment's fundamental protections.

C. Why Sandbagging Is So Problematic and How Governments Rationalize It

Sandbagging is a problem for many reasons. It puts a thumb on the scale for the party that already possesses more power and against the party that is not accused of any wrongdoing. It also distorts the government's role as an impartial entity that is supposed to seek justice rather than victory and distorts the incentives involved in eminent domain.

Eminent domain proceedings present "a classic David-and-Goliath situation" in which the landowner "is confronted by the full legal power of the state, asserting a practically boundless authority to take [their] property against [their] will."[44] Unlike nearly every other form of lawsuit or court case, eminent domain proceedings involve no true "defendant" or party accused of wrongdoing.[45] Rather, condemnees find themselves mired in potential litigation surrounding their property through no fault of their own and "solely because their property is coveted by another."[46] This distinctive posture stems from the fact that condemnation proceedings and the procedures surrounding them have distinct and separate roots from traditional lawsuits under the English common law system.[47]

Therefore, the government's role should not be viewed as that of a plaintiff pressing for its rights, but rather as an impartial entity attempting to fairly compensate those who lose their property through eminent domain.[48] In fact, many government entities require those charged with administering condemnation proceedings to take an oath swearing that they will "faithfully and impartially ascertain the amount of just compensation to which a party is entitled."[49] Because of this obligation, condemning authorities have been likened to prosecutors, whose job is not to just "win" a case but rather to "do justice."[50]

Not only does sandbagging exacerbate this unequal power dynamic inherent in all condemnation proceedings, it also

41 See *supra* note 38. It is worth noting that the sample of sandbagging cases I've provided is far from a comprehensive list. The terms "sandbagging" and "lowballing," while gaining currency among members of the eminent domain bar, are not universal terms used to describe these types of tactics, making case law searches difficult. Further, as touched upon above, most eminent domain condemnation disputes are settled out of court, which means that any reported cases are just the tip of the iceberg when it comes to gauging the true extent of the sandbagging phenomenon.

42 Hinkle, *supra* note 32.

43 *See* Marks, *supra* note 5 (quoting a Virginia eminent domain attorney saying that more and more sandbagging cases are springing up across the state); Michael Rikon, *The Second Higher Appraisal: Stop the Games and Produce It*, Bulldozers At Your Doorstep (May 13, 2015), http://eminent-domain-blog.com/second-higher-appraisal-stop-games-produce/ ("In New York, we frequently see Condemnors file and exchange lower appraisals than the one used to pay an advance payment."); A. Barton Hinkle, *VDOT muscle: An eminently unfair practice*, Richmond Times-Dispatch (Feb. 16, 2014, http://www.richmond.com/opinion/our-opinion/bart-hinkle/article_f39ebb87-2adf-51f7-beae-e97500450530.html (quoting Prof. Gideon Kanner as saying that the practice of sandbagging is "very, very common").

44 Brief for Pacific Legal Foundation and ACLU Fund of Michigan as *Amici Curiae* Supporting Defendant-Appellants, County of Wayne v. Hathcock, Nos. 124070-124078, at 15 (Mich. 2004), http://www.aclumich.org/sites/default/files/file/pdf/briefs/poletownamicusbrief.pdf; *see also* Ridgely, *supra* note 3, at 322 ("[T]he citizen knows that the government wields the power of eminent domain and will exercise it if the parties cannot come to a favorable agreement. The property owner faces an uneven playing field … The government's access to eminent domain gives the government more leverage in negotiations; thus, property owners are automatically disadvantaged.").

45 *See* Trout v. Commonwealth Transp. Comm'r of Virginia, 241 Va. 69, 73 (Va. 1991) ("[T]he parties to a condemnation proceeding are not in the position of plaintiffs and defendants in traditional actions or suits. The exercise of the power of eminent domain, and the implementation of the constitutional just-compensation clause which circumscribes it, grow out of an entirely different history.").

46 Brief for Owner's Council of America as *Amici Curiae* Supporting Appellants, *Ramsey v. Comm'r of Highways*, No. 140929 (Va. 2015), at 7, https://www.scribd.com/document/250389854/Amicus-Brief-of-Owners-Counsel-of-America-in-Ramsey-v-Commissioner-of-Highways-Record-No-140929-Virginia-Supreme-Court ("An owner in an eminent domain action has done nothing wrong, broken no promises, and committed no negligence; he or she is mired in litigation solely because their property is coveted by another.").

47 *See id.* ("The exercise of the power of eminent domain, and the implementation of the constitutional just-compensation clause which circumscribes it, grow out of an entirely different history."); Hamer v. School Bd. of the City of Chesapeake, 240 Va. 66, 72-73 (Va. 1990) (noting that condemnation proceedings originated under English common law pursuant to a writ of *ad quod damnum*, which was later modified under the American system to ensure due process guarantees).

48 *See Hamer*, 240 Va. at 73 (noting that condemning authorities are supposed to be disinterested parties whose role is to impartially ascertain the value of the property at issue, not to act as a jury attempting to decide a case "according to the evidence").

49 *See, e.g.*, Va. Code. § 25.1-230.

50 *See* Owner's Council of America Brief, *supra* note 46, at 7. *See also* United States v. Certain Prop. Located in Borough of Manhattan, 306 F.2d 439, 452-53 (2d. Cir. 1962) ("Just as the Government's interest 'in a criminal prosecution is not that it shall win a case, but that justice shall be done,'

creates perverse incentives for landowners and governments. It discourages landowners from pursuing just compensation challenges, even if they believe they were undercompensated. And it encourages governments to consistently make low initial offers to landowners in an effort to see what they can get away with. After all, as previously discussed, landowners often feel pressure to just accept the government's first offer and avoid the unpleasant hassle of protracted litigation (or the landowners believe that the government would never try to shortchange them).

Given this backdrop, one might wonder how governments could possibly defend their use of lowball offers and sandbagging tactics. The usual justification given by government officials is that they are just trying to protect their taxpaying citizens from overpaying for property that is seized via eminent domain.[51] While this argument may have surface appeal, it creates a "tyranny of the majority" problem in which the government sacrifices the rights of the few (landowners) in favor of the rights of the many (taxpayers). Constitutional rights are not always budget efficient, and rights like those enshrined in the Fifth Amendment are specifically intended to protect minority interests from the masses.

III. Potential Solutions to the Sandbagging Problem

Given the fact that sandbagging appears to be a persistent and growing problem across the United States, it may be appropriate for policymakers and legal reformers to take steps to address it. There are several changes that could be made to current eminent domain law that would help to dissuade governments from lowering appraisals as a means of punishing landowners who hold out for more compensation.

A. Allowing Admission of the First Appraisal or Offer Into Evidence

Perhaps the simplest way to cut back on sandbagging would be to shed more light on the practice. While there has been some increased media attention to the phenomenon of sandbagging, the legal system could also be reformed to make it easier for landowners to expose sandbagging tactics in court. This would mean allowing landowners to introduce evidence of a government's first appraisal in court in order to show that the appraisal was subsequently lowered once the case went to trial.

This could be accomplished by allowing landowners to use the initial appraisal to impeach the state's appraiser when he or she testifies at trial.[52] If the government's appraiser testifies at trial that the value of the property is $64,000, but the same appraiser had originally estimated the value at $200,000, then the landowner should be able to undermine the appraiser's credibility with evidence of the earlier appraisal. Allowing introduction of a higher initial appraisal for impeachment purposes, however, has a significant shortcoming. Governments could elect to switch appraisers midstream to prevent the landowner from using the first appraisal for impeachment purposes.

Courts could also allow evidence of the initial offer as a party admission by the condemning authority, as some courts have already done. In *United States v. 320.0 Acres of Land*, the Fifth Circuit held that statements of just compensation that were provided to a prospective condemnee "are admissible at a subsequent compensation trial as an admission, once it becomes known that at trial the Government is valuing the property at a lower figure."[53] In *320.0 Acres*, the Department of the Interior was seeking to condemn numerous tracts of land as part of the Everglades National Park project.[54] Pursuant to the Uniform Relocation Assistance and Real Property Acquisition Act of 1970—which "exhort[s]" federal agencies to appraise the property at issue, establish an amount the agency believes to be just compensation, and then attempt to acquire the property for this amount—Interior produced initial just compensation estimates, but these were higher ($20,000 and $80,000) than what the government ultimately presented as the value of the tracts at trial ($12,000 and $64,000 respectively).[55]

The federal government argued that the landowners should be barred from introducing these earlier appraisals at trial because they were offers made during a settlement negotiation and thus were excludable under Rule 408 of the Federal Rules of Evidence.[56] The court in *320.0 Acres* rejected this line of argument, noting that estimates of value are distinct from offers made during a negotiation, and pointing out that at the time the appraisals were compiled there were no ongoing settlement

so its interest as a taker in eminent domain is to pay 'the full and perfect equivalent in money of the property taken,' neither more nor less—not to use an incident of its sovereign power as a weapon with which to extort a sacrifice of the very rights the Amendment gives." (citations omitted)).

51 *See* Hinkle, *supra* note 4 (quoting a local town officials as saying the town "has a duty to be the guardian of the taxpayers' hard-earned tax dollars . . . The town cannot squander taxpayers' money by paying an amount that grossly exceeds our experts' appraisal.").

52 *See, e.g.*, County of Costa v. Pinole Point Properties, 27 Cal. App. 4th 1105, 1112-13 (1994) (holding that despite a California statutory provision barring the use of appraisals made in connection with a quick-take deposit for impeachment, if the condemning agency elects to call the appraiser who helped the government prepare its deposit as its valuation witness at trial, that appraiser can be impeached by use of his prior appraisal); *but see* Comm. Redevelopment Agency v. World Wide Enterprises, 77 Cal. App. 4th 1156 (2000) (finding that *Pinole Point* was wrongly decided and holding that appraisals made in connection with a quick-take deposit can never be used at trial). *See also* CMRC Corp., 270 A.D.2d 27 (government argued appraiser's report was immune from discovery because it constituted material prepared for litigation, but court held that if appraiser takes the stand at trial, he would be subject to cross-examination and at that point the report would become discoverable).

53 605 F.2d 762, 824-25 (5th Cir. 1979). The Fourth Circuit, in *Washington Metropolitan Area Transit Auth. v One Parcel of Land*, 548 F.2d 1130 (4th Cir. 1977), held that a landowner who rejected a pre-condemnation offer could not introduce that offer as proof of value in the subsequent condemnation trial. Although at first blush it appears that the Fourth Circuit's holding in *Washington Metro* causes a circuit split with the Fifth Circuit's holding in *320.0 Acres*, the two cases are likely not in tension given that *320.0 Acres* only allowed the introduction of a preliminary statement of just compensation, not an actual offer, into evidence to rebut the government's second lower appraisal.

54 *Id.* at 768.

55 *Id.* at 823-24.

56 *See* Federal Rules of Evidence Rule 408 (forbidding the admission into evidence of offers or statements made during negotiation).

negotiations between the government and the landowners.[57] While acknowledging that the "[g]overnment is [still] free to explain [at trial] why it now believes its earlier appraisal to be inaccurate," the court stated that the government was "not completely free to play fast and loose with landowners—telling them one thing in the office and something else in the courtroom."[58]

The Virginia Supreme Court recently issued a similar holding in the *Ramsey* case, which was discussed above.[59] After the Ramseys rejected VDOT's initial appraisal and offer, the government introduced a much lower appraisal at trial. In response, the Ramseys attempted to introduce evidence of the first appraisal in court. Like the Fifth Circuit in *320.0 Acres*, the Virginia Supreme Court held that Virginia statutory law required condemning agencies to establish a just compensation amount *before* initiating negotiations, meaning that evidence of the initial estimate would not have to be excluded as evidence of settlement negotiations.[60] Furthermore, the *Ramsey* court dismissed concerns of prejudice, ruling that "[t]he probative value of the fact that the [first] appraisal valued the entire property at twice the amount at which [the second appraisal] valued the property outweighs any prejudice to the [condemning authority]."[61]

The court in *Ramsey* also recognized the stakes of this decision by noting that "[p]ermitting the landowner to dispute a condemning authority's contention of a lower value at trial . . . 'will serve as a limited [and wholly appropriate] check on the broad powers of the State in condemnation proceedings.'"[62] As another court put it in a similar context:

> The Constitution of the United States requires that the State deal with the landowner in a fair, honest and above board manner. The State, for the public good, may not coerce private landowners into taking less than fair and adequate compensation for their property. Permitting the landowner to dispute the State's contention of a lower value will serve as a limited check on the broad powers of the State in condemnation proceedings.[63]

While cases like *320.0 Acres* and *Ramsey* provide some protection for landowners by allowing them to expose the government's bait-and-switch tactics,[64] they only have legal force in a few jurisdictions, and thus only apply to a few condemning authorities. Policymakers across the country—particularly at the state level—could also pursue legislation that protects property owners by explicitly allowing the introduction of a condemning authority's first appraisal in the event that the authority seeks to use a lower appraisal at trial. This would go a long way toward exposing instances of sandbagging and would require governments to justify their actions in the public forum of a courtroom.

B. Other Potential Remedies

More aggressive remedies have been suggested to stamp out sandbagging, as well. One idea that has been floated by some eminent domain commentators is a bright line rule barring condemning authorities from lowering a condemnation appraisal or offer at all.[65] In other words, the authority would be tied to whatever offer it initially made and could not lower its just compensation estimate at trial. But this idea has drawbacks. There could be legitimate reasons for a condemning authority to lower its valuation of a piece of condemned property. For example, once the authority enters the land via the quick-take process, it could discover previously-unknown facts that make the property less valuable than originally thought (such as the discovery of hazardous materials that require expensive clean-up).[66]

Another possibility would be to allow landowners to recover litigation expenses and attorney's fees when a condemning authority offers evidence of value in a condemnation proceeding that is below its original deposit, and the ultimate award exceeds the amount of the initial deposit.[67] A variation on this would allow for the recovery of attorney's fees and costs if the condemning authority's second appraisal deviates from its first appraisal by more than a certain amount or percentage. Requiring governments to reimburse the litigation expenses and attorney's fees of landowners in this way could provide a direct

57 *See 320.0 Acres*, 605 F.2d at 823-25.

58 *Id*. at 825.

59 *Ramsey*, 770 S.E.2d 487. *See supra* at Section II.a.

60 *Id*. at 489.

61 *Id*. at 490.

62 *Id*. (citing Mich. Dep't of Transp. v. Frankenlust Lutheran Congregation, 711 N.W.2d 453, 462 (Mich. Ct. App. 2006).

63 Thomas v. State, 410 So.2d 3, 4-5 (Ala. 1981).

64 A few other courts from around the country have come out the same way on this issue. *See, e.g.*, *Thomas*, 410 So.2d at 4-5 (holding that "[i]f the State attempts to establish a lower value, the [prior] statements [of just compensation] are admissible at a compensation trial as an admission by the State."); *Frankenlust Lutheran Congregation*, 711 N.W.2d at 462 ("We hold that a condemning authority is not bound by precondemnation statements and offers of just compensation, and thus may obtain and introduce at trial a different valuation, but if the condemning authority relies on a lower valuation of the property at a subsequent compensation trial, the landowner may introduce evidence of the higher, precondemnation valuation for the purpose of rebutting the authority's lower valuation."); Cook v. State, 430 N.Y.S.2d 507, 509 (N.Y. Ct. Cl. 1980) ("The State should not be allowed to make an admission, and then deny it, without placing its credibility before the trier of fact.").

65 Rikon, *supra* note 43.

66 *See, e.g.*, Community Redevelopment Agency v. World Wide Enterprises, Inc., 77 Cal. App. 4th 1156, 1160-61 (Cal. Ct. of App. 2000) (condemning authority arguing that after it made its initial offer and deposit, it entered the premises and found significant amounts of asbestos in buildings on the property).

67 Letter from Gideon Kanner to California Law Revision Commission, *Attorney Fees in Eminent Domain: Comments of Consultant*, First Supplement to Memorandum 99-7 (June 18, 1999), at 39, http://www.clrc.ca.gov/pub/1999/M99-07s1.pdf.

financial disincentive for governments to engage in sandbagging or lowballing tactics.

IV. Conclusion

Protecting property rights under the Takings Clause extends beyond preventing abuses of the "public use" prong. Governments across the country are using backdoor tactics like sandbagging to systematically deny landowners just compensation when their property is seized through eminent domain. Legislators and policymakers should continue to shine light on these abusive tactics, and push for reforms that would discourage governments from using them.

The Justice Department's Third-Party Payment Practice, the Antideficiency Act, and Legal Ethics

By Paul J. Larkin, Jr.

Note from the Editor:

This article argues that the Justice Department's practice of distributing settlement funds to third parties is illegal and unethical under the U.S. Constitution and federal law.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. Whenever we publish an article that advocates for a particular position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article. We also invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

• Written Testimony of Prof. David K. Min, Before the Subcommittee on Oversight and Investigations of the United States House of Representatives Committee on Financial Services, *Settling the Question: Did Bank Settlement Agreements Subvert Congressional Appropriations Powers?*, (May 19, 2016), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-114-ba09-wstate-dmin-20160519.pdf.

• Testimony of Prof. David M. Uhlmann, Before the United States House of Representatives Judiciary Committee Subcommittee on Regulatory Reform, Commercial, and Antitrust Law, *The Essential Role of Community Service in Addressing the Harm Caused by Environmental Crimes and Other Regulatory Offenses*, (April 28, 2016), *available at* https://www.law.umich.edu/newsandinfo/Documents/Uhlmann_Testimony_Community_Service_Environmental_Crimes.pdf.

About the Author:

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Over the last two presidential administrations, the Department of Justice has directed settling parties to pay some settlement money, not into the U.S. Treasury, but to a third party who was not a party to the suit or a victim of a crime or a tort. Those directives raise several important legal issues because the practice is tantamount to the Department distributing funds that are the property of the United States. The practice has gone largely unnoticed for years, but recently has come under scrutiny by journalists,[1] commentators,[2] and the House of Representatives.[3]

The amount of money at stake is considerable. For example, in 2014 the Justice Department entered into a $17 billion settlement with Bank of America to resolve claims that it had engaged in various mortgage abuses. The third-party payments also raise very troubling problems of cronyism. According to Investor's Business Daily, "[r]adical Democrat activist groups stand to collect millions from Attorney General Eric Holder's record $17 billion deal to settle alleged mortgage abuse charges against Bank of America."[4] How? "Buried in the fine print of the deal, which includes $7 billion in soft-dollar consumer relief, are a raft of political payoffs to Obama constituency groups. In effect, the government has

1 *See* Sean Higgins, *Obama's Big Bank Slush Fund*, Wash. Examiner (Jan. 18, 2016), http://www.washingtonexaminer.com/obamas-big-bank-slush-fund/article/2580431; Kimberley Strassel, *Justice's Liberal Slush Fund*, Wall Street Journal (Dec. 3, 2015), *available at* http://www.wsj.com/articles/justices-liberal-slush-fund-1449188273; Editorial, *Holder Cut Left-Wing Groups In on $17 Bil. BofA Deal*, Investor's Business Daily, (Aug. 27, 2014), *available at* http://news.investors.com/ibd-editorials/082714-715046-holders-bank-of-america-settlement-includes-payoffs-to-democrat-groups.htm?p=full.

2 *See*, *e.g.*, Paul J. Larkin, Jr., *Funding Favored Sons and Daughters: Nonprosecution Agreements and "Extraordinary Restitution" in Environmental Criminal Cases*, 47 Loyola L.A. L. Rev. 1 (2014); Paul J. Larkin, Jr., *The Problematic Use of Nonprosecution and Deferred Prosecution Agreements to Benefit Third Parties*, The Heritage Foundation, Legal Memorandum No. 141 (Oct. 23, 2014), http://www.heritage.org/research/reports/2014/10/the-problematic-use-of-nonprosecution-and-deferred-prosecution-agreements-to-benefit-third-parties; *cf.* Todd David Pearson, *Protecting the Appropriations Power: Why Congress Should Care About Settlements at the Department of Justice*, 2009 BYU L. Rev. 327, 332-33 (2009).

3 *See*, *e.g.*, *Settling the Question: Did the Bank Settlement Agreements Subvert Congressional Appropriations Power?*, Hearing before the Subcomm. on Oversight and Investigations of the H. Comm. on Financial Services, 114th Cong. (2016); *Hearing on H.R. 5063: The "Stop Settlement Slush Fund Act of 2016*," Hearing Before the Subcomm. on Regulatory Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary, 114th Cong. (2016); *Hearing: "Consumers Shortchanged? Oversight of the Justice Department's Mortgage Settlements*, Hearing Before the Subcomm. on Regulatory Reform, Commercial and Antitrust Law of the H. Comm. on the Judiciary, 114th Cong. (2015).

4 Editorial, *supra* note 1. The settlement agreement with Bank of America resolved one pending case and numerous other investigations that the Justice Department has pursued into alleged mortgage fraud that have not resulted in criminal charges or civil complaints. *See* Bank of America Settlement Agreement (signed Aug. 18-20, 2014), *available at* http://www.justice.gov/iso/opa/resources/9622014821111642417595.pdf.

ordered the nation's largest bank to create a massive slush fund for Democrat special interests."[5]

The Justice Department (DOJ or Department) acknowledges that the settlement agreements require that what it has termed "donations" be paid to third parties.[6] The Department also appears to confess that those third parties are not victims of the banks' wrongdoing. As the Department noted in its January 6, 2015, letter to Chairmen Bob Goodlatte and Jeb Hensarling, "the consumer relief provisions in the Bank of America and Citigroup settlements [the Housing Settlement Cases]" require those banks to make "donations to certain categories of community development funds, legal aid organizations, and housing counseling agencies[.]"[7] The Department, however, did not identify any express statutory authority to disburse federal funds to those private parties. Instead, the government defends those requirements on the ground that they are reasonable because the amount at issue is "a much smaller commitment" than what the banks must pay to the federal government, because the "donations are calibrated to provide assistance to those consumers and communities most in need of help," and because "the banks are responsible for choosing specific recipients of consumer relief funds."[8]

The short answer to those defenses, however, is that the Constitution requires express statutory authority to make such disbursements, and the relevant statutes, far from authorizing this practice, expressly prohibit it. The result is that the Department's practice is improper and unlawful for three reasons: (1) it subverts Congress' authority under the Appropriations Clause, (2) it is an end run around two acts of Congress—the Miscellaneous Receipts Act[9] and the Antideficiency Act[10]—that implement the Appropriations Clause, and (3) it violates accepted principles of ethics. Congress has considered prohibiting this practice by legislation. It tried to do so last year via an appropriations rider offered by Representative Bob Goodlatte that ultimately failed. Rep. Goodlatte has reintroduced his rider as a stand-alone bill that the House Judiciary Committee recently passed and sent to the floor. That bill could help bring this practice to an end.

I. The Federal Appropriations Process

The federal appropriations process involves a combination of constitutional provisions, federal statutes, and congressional practices. Article I of the Constitution addresses not only how the federal government may make a "Law,"[11] but also how it may disburse funds.[12] The Appropriations Clause provides that "[n]o Money shall be drawn from the Treasury, but in Consequence of Appropriations made by Law."[13] To prevent either the Congress or the President from looking the other way on any financial matter, the Statement and Accounts Clause requires that "a regular Statement and Accounts of the Receipts and Expenditures of all public Money shall be published from time to time."[14]

Two statutes implement the Appropriations Clause: the Miscellaneous Receipts Act and the Antideficiency Act. The former requires government officials to deposit all funds that they receive into the U.S. Treasury so that they are subject to the appropriations process.[15] The latter statute provides that the government may spend only the money appropriated by Congress and only for the purposes it has specified.[16] In fact, it is a federal offense for a government officer to spend money in excess of the sum that Congress has appropriated.[17] Together with the Appropriations Clause, those statutes, to paraphrase Yale Law School Professor Kate Stith, generate "two governing principles."[18] One is the "*Principle of the Public Fisc*," under which "[a]ll funds belonging to the United States—received from whatever source, however obtained, and whether in the form of cash, intangible property, or physical assets—are public monies, subject to public control

5 Editorial, *supra* note 1.

6 *See* Letter from Peter J. Kadzik, Ass't Att'y Gen'l, to Bob Goodlatte, Chairman, H. Comm. on the Judiciary, & Jeb Hensarling, Chairman, H. Comm. on Financial Servs. 1-3 (Jan. 6, 2015).

7 *Id*. at 2-3.

8 *Id*. at 1-2.

9 Act of Mar. 3, 1849, ch. 110, 9 Stat. 398 (codified as amended at 31 U.S.C. § 3302(b) (2012)).

10 Act of Mar. 3, 1905, ch. 1484 § 4, 33 Stat. 1214, (codified as amended at 31 U.S.C. §§ 1341-1351 (2012)).

11 *See* U.S. Const. art. I, § 7; INS v. Chadha, 462 U.S. 919 (1983); U.S. House of Representatives v. Burwell, Civil Action No. 14-1967 (RMC), slip op. 2 (D.D.C. May 12, 2016). To ensure that neither Congress nor the President can evade that intentionally onerous procedure and create a "Law" by labeling a proposal as something other than a "Bill," Article I expressly applies to any "Bill" and "[e]very Order, Resolution, or Vote" requiring the approval of both chambers other than an "Adjournment."

12 The constitutional regulations on federal receipts and federal expenditures work hand-in-hand. *See* Kate Stith, *Congress' Power of the Purse*, 97 Yale L.J. 1343, 1345 (1988).

13 U.S. Const. art. I, § 9, cl. 7. That last term—"Law"—is critical because it is the identical term used elsewhere in Article I to describe what Congress may enact with the President's approval or over his veto. *Compare* U.S. Const. art. I, § 7, cl. 2, *with id*. § 9, cl. 7.

14 U.S. Const. art. I, § 9, cl. 7.

15 *See* 31 U.S.C. § 3302(b)(a) ("Except as provided by another law, an official or agent of the United States Government having custody or possession of public money shall keep the money safe without—(1) lending the money; (2) using the money; (3) depositing the money in a bank; and (4) exchanging the money for other amounts."); *id*. § 3302(b) ("Except as provided in section 3718(b) of this title, an official or agent of the Government receiving money for the Government from any source shall deposit the money in the Treasury as soon as practicable without deduction for any charge or claim."); Stith, *supra* note 21, at 1364-70. Separate legislation has created exceptions for debt collection actions, revolving funds, and gifts to agencies. *See* Stith, *supra* note 21, at 1365-66. The Justice Department settlement practice is not authorized by legislation and cannot be squeezed into one of those cubbyholes.

16 The Antdeficiency Act prohibits the government from "mak[ing] or authoriz[ing] an expenditure or obligation exceeding . . . an appropriation" or relevant fund. 31 U.S.C. § 1341(a)(1)(A) (2012). Appropriations also must be expended during the life of the relevant authorization bill. Agencies cannot "bank" any remaining funds. *See* 31 U.S.C. § 1502 (2012).

17 OPM v. Richmond, 496 U.S. 414, 430 (1990) (citing 31 U.S.C. §§ 1341 & 1350 (2012)).

18 *See* Stith, *supra* note 12, at 1356. Professor Stith formulated those principles in her discussion of the teachings of the Appropriations Clause, *id*. at 1356-60, but they carry through when the Miscellaneous Receipts and Anti-Deficiency Acts are added to the mix. *Id*. at 1363-77.

and accountability."[19] The other is the "*Principle of Appropriations Control*," the proposition that "[a]ll expenditures from the public fisc must be made pursuant to a constitutional 'Appropriation[ ] made by Law.'"[20] Combined, those principles establish that "there may be no spending in the name of the United States except pursuant to legislative appropriation."[21]

II. Legal Problems with the DOJ Settlement Practice

The DOJ's settlement practice is likely illegal for three different reasons. First, the Justice Department lacks the authority to hand over unappropriated government funds to parties of its choosing. The Constitution and federal law dictate how taxpayers' money can be disbursed, and those authorities teach that it is Congress's prerogative to decide who should receive federal funds.[22] Congress also takes this constitutional responsibility seriously, as witnessed by the detailed allocations of federal funds made by the annual appropriations bills it passes. Congress does not give the President a lump sum allowance that he can spend as he sees fit. Rather, Congress specifies in detail exactly which person or entity is to receive appropriated funds, how much money each one gets, and for what purposes that money can be used. The DOJ's settlement practice therefore is an end run around Congress's constitutional role in deciding how taxpayer money should be spent.

The Supreme Court has, from time to time, treated various constitutional provisions as pliable. The Appropriations Clause, however, is not one of them. In its first decision addressing the clause, the Supreme Court unanimously held in *Reeside v. Walker* that "[i]t is a well-known constitutional provision, that no money can be taken or drawn from the Treasury except under an appropriation by Congress."[23] The Court has reaffirmed that proposition on several occasions.[24] In 1976, for example, the Court noted that "[t]he established rule is that the expenditure of public funds is proper only when authorized by Congress, not that public funds may be expended unless prohibited by Congress."[25] That is the case even when the President exercises a prerogative like the clemency power.[26] The President has plenary authority to grant clemency, the Court ruled, but he "cannot touch moneys in the treasury of the United States, except expressly authorized by act of Congress."[27]

The second objection to the DOJ's settlement practice is that it allows the Justice Department to pick and choose among organizations that should receive federal funds without any guidance from Congress or any oversight by the Judiciary or Appropriations Committees in either chamber. The entirely discretionary nature of this process can easily lead to favoring one charity or organization over another on entirely subjective—or even cronyist—grounds. The parties who benefit from the government's practice may be worthy recipients of federal funds because they improve the lot of the citizenry in particular ways (perhaps by helping to improve the environment in areas that a corporation allegedly damaged). But why should, for example, an environmental organization receive money that could just as easily go to a school that trains dogs to serve as guides for the blind? If there is no guarantee that the payments a settling corporation makes to a third party chosen by the government will go to the actual victims of the alleged wrong, why should one worthy organization receive funds rather than another? A reasonable argument can be made that any number of other charitable organizations equally deserves the same opportunity to assist people in need of better food, drinking water, health care, education, public transportation, housing, and so forth. The usual and constitutional answer to this difficult choice between equal goods is to leave it to the tough negotiations among elected representatives in Congress to decide. But the DOJ's practice avoids that very process in favor of a non-public and unaccountable decisionmaking process that is liable to unknown and unredressable bias. The decision how to disburse federal funds should not be made in a process that shrouds how those decisions are made and empowers unaccountable decisionmakers to rely on personal biases.

Article I of the Constitution empowers Congress to make appropriations in order to minimize opportunities for executive cronyism. As noted above, the conditions in the Housing Settlement Cases are an archetypal example of the corruption that Article I sought to prevent. These conditions allow the Justice Department to pick and choose among private recipients of "donations" without any direction from Congress or any oversight by the Judiciary or Appropriations Committees. Even if Justice Department lawyers act with noble motives, Article I requires Congress to make funding decisions to avoid the risk of cronyism, a risk that is heightened whenever funds are dispensed to an administration's political allies. In sum, these agreements are precisely what the Framers had in mind when they denied executive officials the authority to decide how to disburse federal money.

The third objection that could be raised is that the practice denies the public the opportunity to know how public funds are spent and to hold elected officials accountable for their choices. The Constitution and federal law combine to ensure that the Executive Branch cannot spend money without the prior direction of Congress. That rule ensures that the electorate knows what every member of Congress does with his or her tax dollars and can use that information every two or six years when a new

19 *Id.* at 1356.

20 *Id.* at 1356-57.

21 *Id.* at 1357.

22 *Supra* text accompanying notes 13-21.

23 52 U.S. (11 How.) 272, 291 (1850).

24 *See* Knote v. United States, 95 U.S. 149, 154 (1877); Hart v. United States, 118 U.S. 62, 66 (1886); Cincinnati Soap Co. v. United States, 301 U.S. 308, 321-22 (1937); United States v. MacCollom, 426 U.S. 317, 321 (1975) (plurality opinion); OPM v. Richmond, 496 U.S. 414, 424-30 (1990); *cf.* Federal Crop Ins. Corp. v. Merrill, 332 U.S. 380, 385-86 (1947); Heckler v. Cmty. Health Servs. of Crawford Cnty., Inc., 467 U.S. 51, 63 (1984).

25 *MacCollom*, 426 U.S. at 321.

26 *Knote*, 95 U.S. 149. *Knote* addressed the issue whether the President could pardon a former supporter of the Confederacy and also direct the U.S. Treasury to pay him for property taken from him during the Civil War. The President had the authority to accomplish the former, the Court ruled, but not the latter, since only an act of Congress can authorize a payment of funds once deposited in the treasury.

27 *Id.* at 153-54.

election comes around to decide whether to "throw the bums out." By letting the Executive Branch make decisions that the Constitution envisions that they will make, the members of Congress who allow this practice to continue are asking the voters to ignore the man behind the curtain in the hope that they will not be held accountable at the polls for any funding decisions that the public dislikes. The DOJ settlement practice therefore denies the public valuable information needed to make informed decisions at the polls.

III. Ethical Problems with the DOJ Settlement Practice

Consider this hypothetical: You have hired a lawyer to represent you in a tort case in which you will be entitled to receive money if you win or settle. You win the case or settle it favorably, and your attorney is now discussing with your opponent's counsel how you will be paid. Imagine your lawyer saying to opposing counsel: "I know that my client is due $1 million, but he doesn't need that much money. He makes a good income and can get by with $750,000. Take the other $250,000 and give it to a charity that appears on a list I will give you. Better yet, just give the money to a person or organization of your own choosing. I don't care how the recipient uses the money, and I'm not going to audit how it is spent. Just give me $750,000 for my client, and we'll call it a day."

No private lawyer could direct a defendant to divert settlement funds from the lawyer's client to someone else whom either the lawyer or the defendant believes can make a better use of them. That conduct is inconsistent with the duty of undivided loyalty that all attorneys owe their clients, and any lawyers who engaged in that practice would clearly violate their ethical obligations to zealously represent their clients.[28] Any state bar association would revoke or suspend the license of any lawyer who told a defendant or potential defendant, without the client's approval, to give a portion of settlement proceeds to someone else.

The ethical obligations imposed on private lawyers by state bar rules and the profession's code of conduct apply to Justice Department attorneys. The McDade Amendment, codified at Section 530B of Title 28, subjects every "attorney for the Government" to the "State laws and rules" of ethics applicable to other lawyers licensed to practice in each state in which an attorney appears in court to represent the United States.[29] The term "State laws and rules" includes all rules governing the "ethical conduct" of an attorney in the relevant jurisdiction unless there is a specific federal statute or regulation to the contrary.[30] The McDade Amendment and the implementing Justice Department regulations direct all Department lawyers, "including supervisory attorneys,"[31] to comply with the ethical rules of each relevant state. Accordingly, even though the Attorney General is responsible for managing litigation in the federal courts[32] and, as the "Principal Officer" at the Justice Department,[33] for supervising the conduct of all other Department personnel, Congress has imposed on Department lawyers, including the Attorney General, the same ethical duties that the states demand of non-government lawyers.

The requirements imposed by state-law ethical principles parallel the ones required by the Miscellaneous Receipts Act. Both the former and the latter demand that a government lawyer turn over all settlement funds received from an adversary *to the client*. In the former case, that client is the plaintiff in the tort action. In the latter, the client is the United States or the public as a whole. By directing a defendant to give a third party money that properly belongs to the client, Justice Department lawyers are violating not only the Miscellaneous Receipts Act, but also the McDade Amendment and their ethical duty to act in their client's interests.

IV. Proffered Defenses to the DOJ Settlement Practice

Curiously, the Justice Department has not offered a defense to the criticisms levelled against its settlement practice.[34] Instead, Professors David Uhlmann and David Min defended the Department's position before Congress.[35] Professor Uhlmann, a

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28 *See* ABA, Model Rules of Professional Conduct Rule 1.2: Scope of Representation and Allocation of Authority Between Client and Lawyer (2016) ("A lawyer may take such action on behalf of the client as is impliedly authorized to carry out the representation."); *id*. Rule 1.7 Conflict of Interest: Current Clients; *cf*. *id*. Rule 1.15: Safekeeping Property.

29 The McDade Amendment, 28 U.S.C. § 530B (2012), which is captioned "Ethical standards for attorneys for the Government," provides as follows:

> (a) An attorney for the Government shall be subject to State laws and rules, and local Federal court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in that State.
>
> (b) The Attorney General shall make and amend rules of the Department of Justice to assure compliance with this section.
>
> (c) As used in this section, the term "attorney for the Government" includes any attorney described in section 77.2(a) of part 77 of title 28 of the Code of Federal Regulations and also includes any independent counsel, or employee of such a counsel, appointed under chapter 40.

The implementing regulations apply to lawyers at the Justice Department and in the U.S. Attorneys' Offices whether engaged in criminal or civil enforcement proceedings. 28 C.F.R. § 77.1-77.3 (2016). The regulations impose the same ethical obligations on those lawyers that apply to other lawyers in a relevant state. *Id*. § 77.3 ("In all criminal investigations and prosecutions, in all civil investigations and litigation (affirmative and defensive), and in all civil law enforcement investigations and proceedings, attorneys for the government shall conform their conduct and activities to the state rules and laws, and federal local court rules, governing attorneys in each State where such attorney engages in that attorney's duties, to the same extent and in the same manner as other attorneys in that State, as these terms are defined in § 77.2 of this part.").

30 28 C.F.R. §§ 77.1(b), 77.1(c), 77.2(h), 77.2(k), and 77.

31 28 C.F.R. § 77.4(e).

32 *See* United States v. San Jacinto Tin Co., 125 U.S. 273, 279 (1888).

33 U.S. Const. art. II, § 2, cls. 1 & 2.

34 The Office of Legal Counsel (OLC) has offered its opinion on whether certain unusual payments or practices would violate the Miscellaneous Receipts Act. *See* Deputy Ass't Att'y Gen'l C. Kevin Marshall, Off. of Legal Counsel, Dep't of Justice, *Application of the Government Corporation Control Act and the Miscellaneous Receipts Act to the Canadian Softwood Lumber Settlement Agreement*, Memo. Opinion for the Gen'l Counsel U.S. Trade Rep. (Aug. 22, 2006) (hereafter OLC, *Canadian Softwood*); Deputy Ass't Att'y Gen'l Larry A. Hammond, Off. of Legal Counsel, Dep't of Justice, *Effect of 31 U.S.C. § 484 on the Settlement Authority of the Attorney General*, Memo. Opinion for the Associate Attorney Gen'l (June 13, 1980) (hereafter OLC, *Settlement Authority*).

35 *See* Written Testimony of Prof. David K. Min, Before the Subcommittee on

former Section Chief of the Environmental Crimes Section of the Justice Department's Environment and Natural Resources Division (ENRD), argued that third-party payments, which he described as "community service" agreements, are often used because they are "the best way to ensure that the generalized harm that often occurs in environmental crimes [is] addressed by the defendant."[36] Focusing on the Department's settlements with some major U.S. banks in cases involving alleged fraud in mortgages, Professor Min argued that this practice is subsumed within the Attorney General's authority to settle cases if two criteria are met: "(1) the settlement is executed before an admission or finding of liability in favor of the federal government;" and "(2) the federal government does not retain post-settlement control over the disposition or management of the funds or any projects carried out under the settlement, except for ensuring that the parties comply with the settlement."[37]

There is no merit to the argument that appropriations rules do not apply because settlement funds never come directly into the federal government's possession. In fact, the Department has taken the exact opposite position in criminal cases. The Justice Department has prosecuted numerous high-level drug traffickers whose fingerprints never showed up on any of the packages being imported, distributed, or sold, but who directed how those drugs should be distributed. The government is involved in parallel conduct here. The only difference is that it is directing a third party to transfer money rather than cocaine. Given that the Department has taken the position in criminal cases that the ability to manage distribution of an item—whether drugs, money, guns, or widgets—implicates a person in the distribution even if he never physically touched the item at issue, Professor Min should not treat as exculpatory the fact that the Department directs a defendant to give the money to a third party rather than passing the funds through the government's coffers on the way to its destination.

Atop that, the central flaw in the professors' arguments is that, regardless of whether this practice is reasonable, the text of the Miscellaneous Receipts Act quite clearly forbids it. The Department has broad settlement authority, but it cannot settle a case in a manner prohibited by law, and in this case the Miscellaneous Receipts Act provides the governing law. Moreover, OLC opinions are not the law; they are just one interpretation of it.[38] Perhaps the environmental "community service" agreements described by Professor Uhlmann and the housing assistance projects defended by Professor Min are reasonable ways to rectify environmental insults suffered by a community when a company causes widely distributed environmental harm and housing problems suffered by the poor when banks practice abusive lending. But that is a decision to be made by Congress, which could require some oversight regarding how the money will be spent. Money is fungible, so the funds that third parties receive from these settlements can underwrite activities that Congress never would have funded, and sometime perhaps expressly declined to do so. Oversight therefore is necessary.

Professor Uhlmann did not address the argument that the Department's practice violates state ethical laws incorporated by the McDade Amendment, but Professor Min did. His response, though, is only that government lawyers are not in the same position as private attorneys because they must serve the public. It is true that government lawyers must serve the public—that's a given; the question is how. Congress has decided to regulate the conduct of government lawyers by subjecting them to the same ethical rules that would apply to a lawyer practicing in the same state. Unless the McDade Amendment is unconstitutional—a position that the Justice Department has not taken—that statute defines how government lawyers must act. If state bar rules forbid

Oversight and Investigations of the United States House of Representatives Committee on Financial Services, *Settling the Question: Did Bank Settlement Agreements Subvert Congressional Appropriations Powers?*, (May 19, 2016), *available at* http://financialservices.house.gov/uploadedfiles/hhrg-114-ba09-wstate-dmin-20160519.pdf; (hereafter *Min Testimony*). Testimony of Prof. David M. Uhlmann, Before the United States House of Representatives Judiciary Committee Subcommittee on Regulatory Reform, Commercial, and Antitrust Law, *The Essential Role of Community Service in Addressing the Harm Caused by Environmental Crimes and Other Regulatory Offenses*, (April 28, 2016), *available at* https://www.law.umich.edu/newsandinfo/Documents/Uhlmann_Testimony_Community_Service_Environmental_Crimes.pdf (hereafter *Uhlmann Testimony*).

36 *Uhlmann Testimony* 5.

37 *Min Testimony* 5 (footnote omitted). Professor Min relies on the OLC opinions noted above, but they are inapposite. The first one, OLC, *Settlement Authority*, involved a lawsuit jointly brought by the United States and the Commonwealth of Virginia for damage to wildlife caused by the defendant's oil spill. The opinion makes it clear that "the fact that no cash actually touches the palm of a federal official is irrelevant for purposes of [the Miscellaneous Receipts Act], if a federal agency could have accepted possession and retains discretion to direct the use of the money." *Id.* at 688. In that case, however, the federal government could allow the defendant to pay wildlife damages to a private waterfowl organization because "the United States has not incurred any expense or monetary loss in connection with" the wildlife destroyed by the defendant's oil spill, and the "co-plaintiff, the Commonwealth of Virginia . . . has an independent claim to these damages, grounded in the traditional *parens patriae* authority of state sovereigns." *Id*. at 688. The other opinion involved a complicated international trade dispute and "atypical scenario" private parties brought a claim against the government for damages, and a proposed settlement would have the government essentially serve as an escrow agent for the distribution of certain funds. OLC, *Canadian Softwood*. OLC concluded that "[t]he real issue in dispute is to whom the United States should give the funds—to private American parties pursuant to the Byrd Amendment [Section 1003 of the Continued Dumping and Subsidy Offset Act of 2000, Pub. L. No. 106-387, 114 Stat. 1549, 1549A-73 (2000) (codified at 19 U.S.C. § 1675c (West Supp. 2006], or to the Canadian Producers as a refund pursuant to federal law, *see*, *e.g.,* 19 U.S.C. § 1673(f) (2000) (permitting the "refund[s]" of duties that were improperly assessed.)." OLC, *Canadian Softwood*, *supra*, at 9. Accordingly, OLC found that "there is little basis for attributing any of the $450 million to the United States." *Id*. Yet, because it was "conceivable" that the disputed funds could wind up belonging to the United States depending on the outcome of litigation in the Court of International Trade and arbitration pursuant to the North American Free Trade Agreement, *id.*, OLC went on to address the applicability of the Miscellaneous Receipts Act. The OLC opinion concluded that the act does not bar the government from holding the funds in escrow for others because no count had yet held that the United States has a right to the funds and no governmental agency will exercise any control over the funds once they are in a third party's hands. *Id.* at 9-10. Professor Min also maintains that the Ninth Circuit in *Sierra Club v. Elec. Controls Design, Inc.*, 909 F.2d 1350 (1990), "has upheld this reasoning," *Min Testimony* 5, but that is clearly mistaken. The *Elec. Controls Design* decision does not cite or discuss the Miscellaneous Receipts Act.

38 *Cf.* Mitchell v. Forsyth, 472 U.S. 511, 520-24 (1985) (ruling that the Attorney General is not entitled to absolute immunity for his actions).

an attorney from giving away money due to his client—as all of them do—the government may not do so either. It is easy to forget that Justice Department lawyers, even though they report to the Attorney General, owe their ultimate loyalty, not to any particular Attorney General or President, but to the Constitution, to which they take an oath of loyalty,[39] and to "the People of the United States." Giving away the client's money is an unlawful and unethical practice even when that client is the citizenry.

V. Conclusion

The Justice Department's third-party payment practice is an improper and unlawful disbursement of funds that, by law, must be deposited into the U.S. Treasury, the bank account of the U.S. people. Several different sources of law—the Appropriations Clause and Antideficiency Act implicitly, the Miscellaneous Receipts Act and state ethical rules expressly—separately and together demand that government lawyers deposit into the U.S. Treasury funds they receive in the settlement of cases. No private lawyer could give away a client's settlement money, and no government lawyer may do so either. It is time for this unlawful practice to end.

39 U.S. Const. art. VI, cl. 3 ("[A]ll executive and judicial Officers, both of the United States and of the several States, shall be bound by Oath or Affirmation to support this Constitution[.]").

A Second Look at the CREATES Act: What's Not Being Said

By Erika Lietzan

Note from the Editor:

This article critically discusses the CREATES Act, which is currently pending in the Senate.

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• Written Submission of Robin Feldman, *Hearing on the CREATES Act: Ending Regulatory Abuse, Protecting Consumers and Ensuring Drug Price Competition*, Senate Committee on the Judiciary, Subcommittee on Antitrust, Competition Policy, and Consumer Rights (June 21, 2016) [*Hearing*], *available at* https://www.judiciary.senate.gov/imo/media/doc/06-21-16%20Feldman%20Testimony.pdf.

• Statement of Senator Patrick Leahy, *Hearing*, *available at* https://www.leahy.senate.gov/press/statement-of-senator-patrick-leahy-hearing-on-the-creates-act-ending-regulatory-abuse-protecting-consumers-and-ensuring-drug-price-competition.

• Ameet Sarpatwari, Jerry Avorn, Aaron S. Kesselheim, *Using a Drug-Safety Tool to Prevent Competition*, 370 New Eng. J. Med. 16 (2014), *available at* http://www.nejm.org/doi/pdf/10.1056/NEJMp1400488.

• Jordan Paradise, *REMS as a Competitive Tactic: Is Big Pharma Hijacking Drug Access and Patient Safety?*, 15 Hous. J. Health L. & Pol'y 43 (2015), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2555791.

• Rachel Sachs, *Thoughtful CREATES Act May Help Speed Generic Drug Approvals*, Bill of Health (2016), *available at* http://blogs.harvard.edu/billofhealth/2016/06/17/thoughtful-creates-act-may-help-speed-generic-drug-approvals/.

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In the late 1950s and early 1960s, a German pharmaceutical company marketed a new medicine in Europe that contained thalidomide.[1] Thalidomide was sold—over the counter, for a while, in West Germany—for a variety of uses including the treatment of morning sickness in pregnant women. As it turns out, thalidomide is a powerful "teratogen," meaning it causes severe malformation of embryos and sometimes fetal death. In particular, it leads to phocomelia (in which the hands or feet are attached close to the torso and the limbs are significantly underdeveloped) and amelia (in which the limbs are absent altogether). The U.S. Food and Drug Administration (FDA)—which rejected a new drug application (NDA) for thalidomide at the time—estimates that more than 10,000 children in 46 countries were born with deformities as a result of thalidomide use.[2]

In 1998, FDA finally approved a drug for the U.S. market containing thalidomide. Celgene's Thalomid® was initially approved for treatment of moderate to severe erythema nodusum leprosum, a complication of leprosy. Today, Thalomid is also approved to treat multiple myeloma, a cancer that forms in the white blood cells. FDA conditioned approval on the implementation of rigorous restrictions on distribution of the drug, and Celgene responded with a novel program aimed to achieve zero fetal exposure.[3] Today, pursuant to an FDA–approved "risk evaluation and mitigation strategy" (REMS), Celgene distributes Thalomid through a network of certified pharmacies (which are required to, among other things, counsel patients about the risk) and only in response to prescriptions from specially trained and certified prescribers, who in turn must counsel patients, provide contraception, and administer pregnancy tests. The protocol is enforced through a secure database and assignment of unique authorization codes; the codes are provided once all the steps have been completed, and they are required before a prescription can be filled.[4] Celgene holds patents covering the use of thalidomide to treat multiple

1 For an excellent account of the thalidomide story, see Daniel Carpenter, Reputation and Power: Organizational Image and Pharmaceutical Regulation at the FDA 213–297 (2010).

2 Linda Bren, *Frances Oldham Kelsey: FDA Medical Reviewer Leaves Her Mark on History*, FDA Consumer Magazine (2001), *available at* http://permanent.access.gpo.gov/lps1609/www.fda.gov/fdac/features/2001/201_kelsey.html.

3 *See* Brief in Support of Defendant Celgene Corporation's Motion to Dismiss, Mylan Pharmaceuticals, Inc. v. Celgene Corporation, Case No. 2:14–CV–2094–ESMAH (D.N.J. May 25, 2014) ("Celgene Brief"), at 7–8.

4 *See generally* REMS, Thalomid (Apr. 2016); *see also* Celgene Brief, *supra* note 3.

myeloma and also holds patents on Thalomid's formulation and the REMS.[5]

Notwithstanding the rigorous REMS protocol, Celgene has provided Thalomid to generic drug companies that want to develop and test generic copies of the drug and that agree to Celgene's risk mitigation policies. Celgene has done so when those companies provided documentation and information confirming steps and safeguards that would not only prevent fetal exposure but also minimize the risk for Celgene's business and reputation, such as risk from products liability litigation.[6] Mylan—one of the generic companies—has declined to provide information requested by Celgene, however, and instead filed an antitrust suit that is still pending in federal court.[7]

The story of thalidomide provides helpful context for a bill recently introduced by Senator Patrick Leahy and three colleagues: the "Creating and Restoring Equal Access to Equivalent Samples Act" or CREATES Act. This bill would require innovative drug companies like Celgene to manufacture and sell their products to their competitors, and it would also require these companies to share with these same competitors the use and distribution arrangements they developed to manage the risks of the products.[8] These requirements would apply even if this meant requiring the company to practice its patents for the benefit of its competitors (in the first case) or requiring it to license its patents to or share its trade secrets with the competitors (in the second case).

Earlier proposals relating generally to the same topic, but differing in approach, were introduced in 2014 and 2015 but failed to move forward.[9] Several high profile drug pricing controversies in 2015 and 2016 have placed the biopharmaceutical industry in the congressional and media spotlight, however, and momentum for the CREATES Act has picked up somewhat in the second session of the current Congress.[10] Supporters describe the bill as the latest remedy for the "regulatory abuse" and "predatory delay tactics" of the innovating biopharmaceutical companies and thus part of a broader program to address "high" drug prices.[11]

This article aims to add balance to public discussion of the CREATES Act. It explains some of what is *not* being said—about use and distribution restrictions associated with new medicines, about the underlying complaints from the generics industry, and about the design and likely effect of the bill. Part I discusses pharmaceutical risk management and FDA's decades–old practice of requiring use and distribution restrictions for certain drugs to manage risk. Part II assesses the complaints levied against the research–based companies and the proposals offered to address those complaints. Part III suggests possible practical effects of the proposed legislation and broader implications for innovation policy.

I. Understanding Use and Distribution Restrictions

The heart of the case for the CREATES Act is a complaint that innovative biopharmaceutical companies adopt distribution restrictions for new medicines in bad faith, that is, with the goal and effect of making it more difficult for generic drug companies to develop and market copies—or that the companies, regardless of their motivation in adopting distribution restrictions, misuse those restrictions to the same end. These distribution restrictions generally take the form of REMS, which were authorized under a 2007 amendment to the Federal Food, Drug, and Cosmetic Act (FDCA). The complained–of behavior is often referred to as "REMS abuse," and it is also said to be increasing substantially.

There are some common misperceptions about use and distribution restrictions, which may be coloring the current debate over and whether and why the CREATES Act is necessary. As explained below, new medicines always require post–approval risk management, and FDA has been requiring distribution restrictions in exceptional cases for more than 25 years. The current REMS authority is narrow, limiting the types of restrictions that can be imposed as REMS, as well as the basis for their imposition. Establishing and maintaining a REMS under this authority can also be extremely burdensome. There are fewer REMS with distribution restrictions than people may realize, and many of them are legacy arrangements, imposed by the agency long before the 2007 amendment was passed.

A. Post–Approval Risk Assessment and Management

FDA approval of a new drug under the FDCA or a biological product under the Public Health Service Act (PHSA) represents the agency's conclusion that the benefits of the product outweigh its risks when it is used as labeled, meaning for the indicated population and purpose. Safety and effectiveness are not absolutes; they are always relative. Moreover, every approved medicine has risks. These include *known* risks; for instance, 5% of people in the clinical trials may have experienced a particular side effect (such as nausea) which can now be expected in about 5% of real world patients. Another type of known risk might be a more significant clinical consequence in a very small percentage of patients, which will develop over time but can be prevented if treatment stops when a particular side effect (such as stomach pain) or physiological marker (such as elevated liver enzymes) emerges. These known risks are captured in the product's approved labeling for healthcare professionals. There is also a possibility of *unknown* risks; this is because no premarket clinical program of reasonable length can detect extremely rare side effects, nor can controlled testing identify

5 Celgene Brief, *supra* note 3, at 9.

6 *Id.*

7 *Id.*

8 S. 3056 (114th Cong.) (introduced June 21, 2016).

9 H.R. 2841 (114th Cong.) (introduced June 19, 2015); H.R. 5657 (113th Cong.) (introduced Sept. 19, 2014).

10 The Antitrust subcommittee of the Senate Judiciary Committee recently held a hearing on the bill at which five witnesses spoke in support of the legislation and one witness spoke in opposition.

11 *See* Statement of Senator Patrick Leahy, Hearing on "The CREATES Act: Ending Regulatory Abuse, Protecting Consumers, and Ensuring Drug Price Competition" (June 21, 2016).

all of the consequences that might stem from use in real–world conditions.

As a result of this uncertainty, the "sponsor" of a new medicine—the company that develops the medicine and brings it to market with FDA approval—engages in risk assessment and risk minimization after product approval. The primary way that FDA and a company *assess* the risk of an approved drug or biologic is through pharmacovigilance: the company files quarterly safety reports for the first three years after approval and has a permanent obligation to report individual adverse events that are both serious and unexpected.[12] The primary ways that FDA and a company *manage* the risks of a new drug or biologic are through the approval decision itself and through the labeling that FDA approves for healthcare professionals. This labeling synthesizes all of the information presented in the application and describes the conditions under which the benefits of the medicine are currently understood to outweigh its risks. Thus it describes use of the product to treat (or diagnose or prevent) a particular illness, with a particular dosing regimen, and subject to various precautions and warnings (such as when not to administer it, what sorts of side effects are expected, what should not be combined with it, which side effects might be more concerning, and so forth).[13]

In some instances, these standard means of risk assessment and minimization may be insufficient. With respect to risk mitigation, FDA therefore sometimes requires sponsors to disseminate special labeling for patients that focuses on the risks associated with the products. This practice dates to 1968 and began in earnest in 1970 when FDA required a patient package insert regarding blood clot risk for oral contraceptives.[14] Today, patient labeling often takes the form of a Medication Guide, or "MedGuide." FDA introduced MedGuides in 1995, after it grew concerned that "inappropriate use of prescription medications" was "resulting in serious medical injury."[15] The agency will require a MedGuide for any product that poses a "serious and significant public health concern" such that distribution of FDA–approved patient information is "necessary for the product's safe and effective use."[16]

B. The Development of Use and Distribution Restrictions

In some instances, despite a compelling public health need for a particular product, physician and patient labeling may be insufficient to ensure that the benefits of the product outweigh its risks. For decades, therefore, FDA has imposed use and distribution restrictions on drugs with unusually significant toxicity profiles.

Initially, the agency extracted agreements to restrictions as part of the drug approval process. For example, clozapine, used to treat schizophrenia, can cause agranulocytosis, a deficiency in absolute neutrophils—a type of white blood cell—that can lead to serious infection and death.[17] FDA approved Clozaril® (clozapine) in 1989 only after the sponsor agreed to make distribution of the drug contingent on weekly blood monitoring.[18] The agency similarly extracted an agreement for distribution restrictions when it approved Tikosyn® (dofetilide) in 1999, due to life–threatening arrhythmia.[19] In other cases, safety issues arose after approval, and FDA obtained an agreement to distribution restrictions by threatening to initiate withdrawal proceedings. After approval of the antibiotic Trovan® (trovafloxacin) in 1998, for instance, the agency received reports of over 100 cases of liver toxicity, including 14 reports of acute liver failure, many of which were fatal or required a liver transplant. As an alternative to market withdrawal, FDA issued a public health advisory that "effectively restricted use of this drug to hospitalized patients with certain serious life or limb–threatening infections," and the sponsor agreed to restrict distribution to pharmacies in hospitals and long-term nursing care facilities.[20]

After 1992, the agency sometimes invoked its new "subpart H" regulations.[21] These regulations apply only to products for treatment of serious or life–threatening conditions that provide meaningful benefit over existing treatments.[22] But in addition to authorizing approval on the basis of surrogate endpoints, they authorize approval of a product "shown to be effective" subject to use or distribution restrictions.[23] Although the regulations offer two examples—restricting distribution to particular facilities or physicians with specific training or experience and conditioning distribution on the performance of particular medical procedures—they assert broad authority to impose whatever "postmarketing restrictions" are necessary "to assure safe use."[24] FDA rejected the argument that the statute authorized only an "up or down" decision on an application and that the agency consequently lacked statutory authority to

12 21 C.F.R. §§ 314.80, 600.80.

13 *See* 21 C.F.R. § 201.57.

14 35 Fed. Reg. 9001 (June 11, 1970).

15 60 Fed. Reg. 44182, 44199 (Aug. 24, 1995).

16 21 C.F.R. § 208.1; *see* 63 Fed. Reg. 66378 (Dec. 1, 1998). A Medication Guide will be required if: (1) patient labeling could help prevent serious adverse effects; (2) the product has serious risks relative to its benefits, and information concerning the risks could affect patient decisions to use the product; or (3) the product is important to health, and patient adherence to directions for use is crucial to its effectiveness. 21 C.F.R. § 208.1(c).

17 *See* GAO, FDA Approval of Mifeprex: GAO–08–751 (Aug. 2008), at 44.

18 *See FDA's Accelerated Drug Approval Proposal Would Permit Restricted Distribution of Highly Toxic, Beneficial Products*, The Pink Sheet (Oct. 28, 1991).

19 GAO Report, *supra* note 17.

20 *See* FDA, Risk Assessment and Risk Mitigation Review, NDA 22406 (rivaroxaban), Appendix on Drug–Induced Liver Injury (Feb. 13, 2009) at 25, 34–35 (describing this as an instance "where regulatory action prompted by concern about severe [drug–induced liver injury] included risk management actions which stopped short of market withdrawal").

21 21 C.F.R. part 314, subpart H. The biologics regulations contain parallel authority. 21 C.F.R. part 601 subpart E.

22 21 C.F.R. § 314.500, § 601.40.

23 21 C.F.R. § 314.520, § 601.42.

24 *Id.*

impose restrictions as a condition of approval.[25] This question was never resolved by a court, and amendment of the statute in 2007 mooted the issue.

In the years leading up to the 2007 amendments, FDA embarked on additional initiatives to strengthen its drug safety program. These initiatives included the development of detailed guidance documents on risk assessment and minimization.[26] The guidance on risk minimization, released in draft in 2004 and finalized in 2005, introduced the "Risk Minimization Action Plan," or RiskMAP.[27] FDA identified numerous processes and systems that a drug's sponsor might adopt to minimize its known risks. These included the following:

- Targeted education and outreach to communicate risks and appropriate safety behaviors to healthcare professionals or patients. This might involve training programs for physicians or patients, patient labeling, and patient–sponsor interaction programs like disease management or patient access programs.
- Reminder systems, processes, or forms to foster reduced–risk prescribing and use. This might involve consent forms; healthcare provider training programs (for instance with testing); enrollment of physicians, pharmacies, or patients in data collection systems that reinforce appropriate product use; specialized product packaging that enhances safe use of the product in certain patients; and specialized systems or records to attest that safety measures have been followed.
- Performance–linked access systems that guide prescribing, dispensing, and use of the product to the population and condition of use most likely to confer benefits and minimize risks. This might involve limiting prescription to specially certified prescribers, limiting product dispensing to pharmacies that are specially certified, and limiting dispensing to patients who have evidence or documentation of safe use conditions (for instance, lab results).
- If the goal was ultimately to impose direct conditions on healthcare professionals and patients, the sponsor agreed with FDA that it would impose those conditions itself through appropriate measures. These could include contractual arrangements with individual physicians or pharmacists, pharmacies, and distributors.[28]

By mid–2007, FDA had restricted distribution of nine drugs via subpart H: Actiq® (fentanyl citrate), Accutane® (isotretinoin), Lotronex® (alosetron hydrochloride), Mifeprex® (mifepristone), Plenaxis® (abarelix), Revlimid® (lenalidomide), Thalomid® (thalidomide), Tracleer® (bosentan), and Xyrem® (sodium oxybate).[29] The nature of the safety problems that triggered distribution restrictions varied. Actiq, for instance, is associated with a risk of misuse, abuse, addiction, overdose and serious complications due to medication errors.[30] Thalomid, Revlimid, and Accutane are associated with serious birth defects in developing embryos.[31] Lotronex is associated with the risk of ischemic colitis and serious complications of constipation, resulting in hospitalization, blood transfusion, surgery, and death.[32] Tracleer is teratogenic and also associated with liver failure.[33] The nature of the restrictions also varied.[34] For seven of the nine products, FDA required that distribution be limited to authorized distributors and pharmacies. For eight, FDA required that dispensing or distribution of the drug be contingent on verification that physicians and others had enrolled or registered in the distribution program, or that patients had complied with certain safety measures. For five, the agency required a formal registry of all prescribers and patients. For all nine products,

25 Those who made this argument cited American Pharmaceutical Association (APhA) v. Weinberger, 377 F. Supp. 824, 829 n. 9 (D.D.C. 1974), *aff'd sub nom*. APhA v. Mathews, 530 F.2d 1054 (D.C. Cir 1976) ("As outlined in the Court's opinion, FDA's discretion under the Act's NDA provisions is limited to either approving or denying NDAs and nowhere is FDA empowered to approve an NDA upon the condition that the drug be distributed only through specified channels."). The *Weinberger* case involved methadone, a controlled substance approved as an analgesic and antitussive but not, at the time, for detoxification treatment of opioid addiction. FDA had permitted investigational use for heroin addiction, but grew concerned about diversion and misuse and rescinded this permission. The agency also initiated withdrawal of approval of the eight NDAs and published a regulation that purported to treat the drug as approved for opioid detoxification or maintenance subject to distribution restrictions. *See* 37 Fed. Reg. 26790 (Dec. 15, 1972); 21 C.F.R. § 130.44 (1973). Several commenters argued that the new drug provisions of the FDCA did not authorize the approach in question but gave FDA only three options: distribution controls in connection with investigational status, new drug approval with unrestricted and uncontrolled distribution, or withdrawal from use. The district court found that the regulation exceeded FDA's statutory authority, but appeared to limit the scope of its holding to drugs that are controlled substances, the permissible distribution of which is "clearly within the jurisdiction of the Justice Department." 377 F. Supp. at 831. The case was clearly relevant to the question whether FDA's 1992 accelerated approval regulations were permissible, but it was not directly on point.

26 FDA committed to providing this guidance when Congress reauthorized user fees for the agency in 2002. *See* PDUFA III Reauthorization Performance Goals and Procedures, at § VIII.e.

27 FDA, Guidance for Industry, Development and Use of Risk Minimization Action Plans (March 2005); 69 Fed. Reg. 25130 (May 5, 2004).

28 Scott Gottlieb, *Drug Safety Proposals and the Intrusion of Federal Regulation into Patient Freedom and Medical Practice*, Health Affairs 26, no. 3 (2007): 664–677.

29 *See* GAO Report, *supra* note 17, at 5. FDA originally approved Accutane in 1982, long before it promulgated subpart H. In 2005, however, and with the company's agreement, the agency placed Accutane under subpart H pursuant to a supplemental new drug application.

30 REMS, Transmucosal Immediate–Release Fentanyl Products (Dec. 2014).

31 REMS, Thalomid (Apr. 2016); REMS, Revlimid (Apr. 2016); REMS, Isotretinoin (July 2016).

32 REMS, Lotronex (Apr. 2016).

33 REMS, Tracleer (Dec. 2015).

34 *See generally* GAO Report, *supra* note 17.

FDA required the sponsor to implement an educational program for patients, prescribers, and/or pharmacists.

Also by mid–2007, various products that had not been approved under subpart H were subject to use or distribution restrictions embodied in RiskMAPs. One example was the multiple sclerosis drug, Tysabri® (natalizumab).[35] Biogen Idec had withdrawn Tysabri from the market in 2005 due to cases of progressive multifocal leukoencephalopathy, an opportunistic infection of the brain cells.[36] FDA and Biogen Idec developed a RiskMAP that would allow the drug to be reintroduced a year later.[37] All patients, prescribers, pharmacies, and infusion centers involved in distribution and use of Tysabri were registered and tracked. Distribution was limited to a dozen specialty pharmacies, and administration was limited to around 4500 infusion centers and physician offices. Patients were required to complete a checklist (for instance, confirming that they had not started taking any immunosuppressants) before each infusion to verify continuing eligibility. Baseline MRIs were also recommended.[38] Another example was Accutane® (isotretinoin), an acne medication associated with severe birth defects; FDA did not approve the product under subpart H, and in fact the product was initially marketed only with labeling information about the risk. The education–only approach failed, leading to restricted distribution under a RiskMAP and placement of the drug under subpart H.[39]

C. The Narrow REMS Authority

Following these many years of discussion of risk management, Congress amended the FDCA in 2007 to authorize FDA to impose a REMS with respect to any new drug or biological product. Four points about the new REMS authority are important to understanding the CREATES Act.

First, the standard for imposition of a REMS is high; these strategies were intended to be rare. When it initially approves a product, FDA may require a REMS only if it concludes that the REMS is necessary to ensure the benefits of the drug outweigh its risks.[40] Put another way, the agency may require a REMS only if the drug would not be approvable without the REMS in place.[41] This leads directly to the *second* point, that if the standard for a REMS is understood and applied correctly, enactment of the REMS authority should lead to approval of more drugs than before. If a REMS can be imposed only when necessary to ensure the benefits of the drug outweigh its risks, then the REMS will always make an otherwise unapprovable drug approvable. This could create a perception that more new drugs have REMS after 2007 than had risk management plans prior.

Third, the statute limits the elements in a REMS. Whenever the REMS standard is met, FDA may require: (1) a MedGuide, (2) a patient package insert, or (3) planned communications with healthcare providers.[42] Although the agency had required these tools previously, codification gave it additional enforcement authorities. But FDA may impose use and distribution restrictions only if an *additional* standard is met. Specifically, these restrictions may be imposed only to mitigate a specific serious adverse drug experience identified in the product's labeling, and only if a MedGuide, patient package insert, and plan for communications with healthcare providers are insufficient to mitigate that risk.[43] Moreover, the statute permits only six types of restriction: (1) requiring that prescribers have particular training or experience, or are specially certified; (2) requiring that pharmacies and other dispensers have special certifications; (3) requiring that the drug be dispensed to patients only in certain health care settings, such as hospitals; (4) requiring that the drug be dispensed only to patients with evidence or other documentation of safe–use conditions, such as laboratory test results; (5) requiring that each patient be subject to certain monitoring; and (6) requiring that each patient using the drug be enrolled in a registry.[44] The statute refers to these restrictions as "elements to assure safe use," and they are known more generally by the acronym ETASU.

Fourth, a REMS is a significant undertaking.[45] Designing and developing a REMS and associated tools takes time, and it is an iterative process in which FDA is heavily engaged.[46] The REMS submission must identify the goals of the strategy and lay out pragmatic, specific, and measurable objectives that will lead to processes or behaviors that in turn will lead to achievement of

35 *The Risk of Risk Management*, The Pink Sheet (Jan. 1, 2007).

36 *Tysabri Withdrawn Pending Analysis of Safety Signal in Long Term Trial*, The Pink Sheet (March 7, 2005); *Tysabri Return to Market with Expanded Indication Backed by Committee*, The Pink Sheet (March 13, 2006).

37 *See* Biogen Idec, Form 10–K (Feb. 21, 2007), at 7.

38 *Tysabri Out of Remission; Returns with Updated Indication, Risk Management*, The Pink Sheet (June 12, 2006).

39 *Managing Risk Management: FDA Wants to Gauge Effectiveness of RiskMAPS*, The Pink Sheet (Apr. 3, 2006). *See also supra* note 29.

40 21 U.S.C. § 355–1(a)(1).

41 After a product's initial approval, the agency may impose a REMS only if this standard is met (the REMS is necessary to ensure the benefits outweigh the risks) *and* the agency is acting on new safety information *Id.* § 355–1(a)(2)(A).

42 *Id.* § 355–1(e).

43 *Id.* § 355–1(f)(1).

44 *Id.* § 355–1(f)(3).

45 *See generally* FDA, Draft Guidance for Industry, Format and Content of Proposed Risk Evaluation and Mitigation Strategies (REMS), REMS Assessments, and Proposed REMS Modifications (Sept. 2009). Indeed, this was the goal; as a key health staffer on the Senate HELP Committee explained in early 2007, they "require a lot of work." Managing Risk Management, *supra* note 39.

46 Much of the regulatory history of each REMS—including sometimes the timeline relating to submissions, meetings, and calls with the agency about the proposal, the materials reviewed and informing the review, and evolution in the proposed elements—can be pieced together from the "Administrative Correspondence" and FDA's formal "Risk Assessment and Risk Mitigation Review," both available through the Drugs@FDA database on the agency website. Despite redactions for confidential commercial information, the latter amply illustrate the agency closely reviewing and frequently changing, or dictating, all aspects of REMS with ETASU, from the goals, to elements, to scope (for instance, definitions that effectively dictate which patients are monitored), to design and functionality of written materials.

the goals. (To clarify the distinction: a goal might be to eliminate a particular risk associated with drug–drug interactions, and the objectives might be lowering co–prescribing rates and co–dispensing rates.) Goals and objectives must be explained and justified. If the REMS imposes distribution restrictions, the sponsor must describe the restrictions and any tools (processes or systems) used to implement the restrictions. This may require providing evidence of the effectiveness of the restriction or tool, including results from testing. The sponsor must explain how the restrictions correspond to the risk in question, explain how they will mitigate the risk, verify that the restrictions are not unduly burdensome on patient access to the drug, describe the burden on the healthcare system, explain how the restrictions compare with those required for other drugs with similar risks, and explain how the restrictions are designed to be compatible with established distribution, procurement, and dispensing systems.

FDA must approve every aspect of the REMS, including the restrictions themselves, the tools used to implement the restrictions, and all associated materials—survey documents, methodologies, attestations for physicians to sign, procedures, consent forms, patient education materials, and so forth. The sponsor must establish and follow a timetable for regular assessment of the REMS and must monitor and evaluate the implementation of any distribution restrictions. This can require development and maintenance of a validated and secure database of certified entities, for instance, or creation of a tool and protocol for audits of pharmacies. If the sponsor fails to comply with a requirement of its REMS, the drug is deemed "misbranded" under the FDCA. This gives FDA the ability to seize the product, prosecute the company criminally, and seek injunctive relief.[47] Failure to comply with a REMS requirement can also give rise to civil money penalties.[48]

Since enactment of the REMS provision, FDA has approved several drugs and biologics with REMS that include elements to assure safe use. In 2013, for instance, it approved Adempas® (riociguat) for treatment of chronic thromboembolic pulmonary hypertension and pulmonary arterial hypertension. These are serious and disabling lung conditions, but the drug is teratogenic, which leads to distribution restrictions to minimize the risk of fetal exposure.[49] FDA also approved Opsumit® (macitentant) for treatment of pulmonary arterial hypertension, though this drug, too, is teratogenic.[50] Kynamro® (mipomersin sodium) was approved to treat patients with homozygous familiar hypercholesterolemia, a rare genetic lipid disorder that can lead to low density lipoprotein (LDL, the "bad" cholesterol) levels up to 1000 mg/dL and that is associated with a significantly reduced life expectancy. Kynamro is associated with hepatotoxicity.[51]

The 2007 legislation also imposed REMS requirements, retroactively, on products approved before its effective date.[52] Any already approved drug or biological product with use or distribution restrictions that qualified as ETASU under the statute was deemed to have an approved REMS. In 2008, the agency listed the 18 approved products to which this pertained.[53] Many of the drugs that appear to be a focal point of the current "REMS abuse" controversy—such as Thalomid and Revlimid—were on this list.

D. Other Use and Distribution Restrictions

It is possible for a new drug or biological product to have use or distribution restrictions that do not stem from the statutory REMS authority. The narrowness of the REMS provision means that some legitimate issues must be addressed outside the REMS context. For instance, many biological products, including vaccines, require temperature–controlled ("cold chain") shipping and storage, which may give rise to restricted distribution arrangements. Other products may benefit from distribution restrictions due to an especially high risk of counterfeiting. To give an example, Genentech limits distribution of Avastin® (bevacizumab), approved for treatment of a half dozen different types of cancer, due to extensive counterfeiting.[54] The product may be purchased only from a list of authorized distributors contractually committed to the company to purchase only from Genentech and not to distribute to secondary wholesalers.[55] Counterfeit versions in circulation outside the closed distribution network have lacked the active ingredient, putting patients at risk.[56] Other drugs

47 21 U.S.C. §§ 331, 332, 333(a), 352(y).

48 21 U.S.C. § 333(f)(4)(A).

49 REMS, Adempas (Dec. 2015).

50 REMS, Opsumit (Feb. 2016).

51 REMS, Kynamro (July 2015).

52 Pub. L. No. 110–85, § 908(b).

53 These were: Plenaxis (abarelix), Lotronex (alosetron), Letairis (ambrisentan), Tracleer (bosentan), Clozaril (clozapine), Fazaclo ODT (clozapine), Tikosyn (dofetilide), Soliris (eculizumab), Ionsys (fentanyl PCA), Actiq (fentanyl citrate), Accutane (isotretinoin), Revlimid (lenalidomide), Mifeprex (mifepristone), Tysabri (natalizumab), ACAM2000 (smallpox vaccine), Xyrem (sodium oxybate), and Thalomid (thalidomide). 73 Fed. Reg. 16313, 16314 (Mar. 27, 2008).

54 *See* TK Mackey et al., *After counterfeit Avastin®–what have we learned and what can be done?*, Nat. Rev. Clin. Oncol. 2015 May; 12(5): 302–308; Jack McCain, *Connecting Patients with Specialty Products: The Future of Specialty Drug Distribution*, Biotechnology Healthcare 2012 Fall; 9(3): 13–16.

55 *See* Avastin Distribution, https://www.genentech–access.com/hcp/brands/avastin/learn–about–our–services/product–distribution.html.

56 *See* FDA, Counterfeit Version of Avastin in U.S. Distribution (July 10, 2012).

may be subject to distribution restrictions in connection with resolution of manufacturing compliance issues.[57]

II. Exploring the Complaints Relating to Generic Drugs and Biosimilar Biologics

This part explores the concerns that have been raised about the impact of use and distribution restrictions—including REMS with ETASU—on approval of generic drugs and biosimilar biologics. It begins by describing the relationship between abbreviated approval of generic drugs and biosimilar biologics and innovator intellectual property. It then analyzes the complaints that the CREATES Act purports to address and the solutions that the bill offers.

A. Abbreviated Approvals and Innovator Intellectual Property

An innovator's new drug or biologics license application typically contains data from dozens of laboratory, animal, and clinical trials, gathered over as many as ten or twelve years. Abbreviated applications generally propose a copy (or near–copy in the case of a biosimilar) and rely on this research. Although they may rely on this research (after an appropriate period of time), generic drug and biosimilar applicants are always required to respect the innovator's intellectual property.[58]

The biopharmaceutical industry is highly dependent on patent protection. A variety of different inventions associated with a particular new drug or biologic may be patented. The Patent Act protects the property right of an inventor in "any new and useful process, machine, manufacture, or any composition of matter, or any new and useful improvement thereof."[59] In the case of a new drug or biologic, this could include the drug substance itself (active ingredient), the formulation (a particular combination of active ingredient and inactive ingredients), as well as numerous methods and processes—such as a method of using the product, or a method of manufacturing the product. It could also include how the company implements, monitors, or assesses any particular distribution restrictions, or associated tools, to mitigate the drug's risks. Provided the invention satisfies the statutory requirements of novelty, non–obviousness, and utility, and provided the patent application adequately describes and distinctly claims the invention, federal law protects the inventor's property right for 20 years from the date of the patent application.[60] This in turn means the inventor may exclude—generally for 20 years—any other person from making, using, selling, offering to sell, or importing the invention. Patent law allows a generic or biosimilar applicant to develop its product and submit its application prior to patent expiry, but it does not require the patent holder to assist the applicant in carrying out this activity.[61] Any resulting application during the patent term is deemed an artificial act of patent infringement, facilitating evaluation of patent issues prior to product launch.[62] There is no change to the underlying patent law. The patent owner may therefore exclude, for the term of the patent, the generic or biosimilar applicant from making, using, selling, offering to sell, or importing its invention, whatever that invention might be.

New drug and biologic innovators are also heavily dependent on trade secret protection. Generally speaking, trade secret law protects ideas, inventions, and knowledge that are kept mostly secret by a company (aside from, for instance, disclosure to FDA in a marketing application) and that are valuable to the company because of the secrecy.[63] New drug applications and biologics license applications contain extensive trade secrets and confidential commercial information—including detailed "chemistry, manufacturing, and controls" information about their manufacturing processes, and extensive data from and information relating to years of laboratory, preclinical, and clinical testing.[64] Various materials and processes associated with a use or distribution restriction could be trade secret, including, for instance, internal company protocols associated with auditing third party compliance. Although generic and biosimilar applicants may rely (indirectly) on the research performed by the pioneer *after* a period of "data exclusivity" has expired, they do not have access to the innovator's trade secrets, nor may FDA consider those trade secrets when approving their products.

B. First Complaint: Sale of Reference Products for Testing Purposes

Generic drug and biosimilar applications are comparative applications. An abbreviated new drug application (ANDA) for a generic drug must demonstrate that the proposed generic drug is the same as, and bioequivalent to, an innovator's drug, also known as its reference drug or reference listed drug.[65] The

57 For example, a medically necessary drug might be subject to limited distribution as part of a consent decree that otherwise requires the company to stop manufacture and distribution of its products while it addresses compliance issues. This was the case for Celestone® Soluspan® (betamethasone sodium phosphate and betamethasone acetate) injection and Celestone® (betamethasone sodium phosphate) injection. *See* 71 Fed. Reg. 2047 (Jan. 12, 2006).

58 In addition to patents and trade secrets, discussed in the text, innovators also hold trademarks and, in some cases, may hold copyrights that are relevant.

59 35 U.S.C. § 101.

60 35 U.S.C. §§ 102, 103, 112, 154. In the case of a divisional, continuation, or continuation–in–part patent, the 20–year term begins with the date of the parent patent application.

61 35 U.S.C. § 271(e)(1) (deeming it not an act of infringement to make, use, offer to sell, sell, or import a patented product "solely for uses reasonably related to the development and submission of information under a federal law which regulates the manufacture, use, or sale of drugs or veterinary biological products").

62 35 U.S.C. § 271(e)(2) (deeming it an act of infringement to submit an ANDA or biosimilar application during the patent term if the applicant seeks to market prior to patent expiry—i.e., if the applicant challenges the patent in question).

63 *E.g.*, Restatement (First) of Torts § 757 cmt. b (1939); Uniform Trade Secrets Act § 1(4) (amended 1985); Restatement (Third) of Unfair Competition § 39 (1995).

64 *See generally* 39 Fed. Reg. 44602 (Dec. 24, 1974); 21 C.F.R. §§ 314.430, 601.51.

65 21 U.S.C. § 355(j)(2)(A)(iv). The proposed generic must have the same active ingredient, route of administration, dosage form, and strength, although FDA will permit deviations if no clinical data are necessary to establish its safety and effectiveness. 21 U.S.C. § 355(j)(2)(C). The agency may not require clinical data in a generic application, apart from pharmacokinetic data needed to show bioequivalence. 21 U.S.C. § 355(j)

generic applicant therefore conducts comparative analytical testing to show that the active ingredients are the same, and it conducts modest bioequivalence testing. The latter might entail a comparative pharmacokinetic study in a few dozen healthy volunteers. An abbreviated application for a biosimilar biologic must demonstrate that the proposed biosimilar is highly similar to its reference product and that there are no clinically meaningful differences between the two.[66] A biosimilar applicant conducts comparative analytical testing as well as comparative preclinical and clinical testing; the approvals to date indicate this might entail administration of both products to 500 or even 1000 patients, in some cases for months or even perhaps over a year.

To obtain the reference product for purposes of comparative testing, the generic or biosimilar applicant typically purchases the product from a wholesaler or directly from the innovator. The drug statute (FDCA) and biologics statute (PHSA) do not require the innovator to sell its product to anyone for purposes of comparative testing (or for any other reason); the underlying premise of both schemes, in fact, is that a medicinal product is sold specifically for use in treating, preventing, or mitigating a disease. FDA does not have the authority to require such a sale, nor has it ever asserted that it did. Moreover, there is no statutory exception from the penalties for non–compliance with the REMS provision for sales to a competitor.

1. Generic Companies Unable to Purchase Reference Products

The first cause of action that the CREATES Act would establish responds to a claim that these comparative applications are now sometimes impossible because distribution restrictions make it impossible to acquire restricted drugs from third parties and because the innovators themselves also decline to sell the restricted drugs to their competitors.

It may help to understand how many innovative products could plausibly be at issue. The vast majority of new drugs and biologics are available through normal distribution channels. With the notable of exception Daraprim® (discussed in the conclusion), the public controversy over "abuse" of distribution restrictions appears to relate to products distributed under REMS. This is why it is generally called "REMS abuse." There are, however, only 42 REMS with use or distribution restrictions (ETASU).[67] Of these, six are REMS with ETASU shared by innovators and generic companies, and another REMS with ETASU belongs to a generic company.[68] In other words, the drugs with these seven REMS already have approved generic copies. As a practical matter, therefore, there are 35 new molecular entities with REMS that include ETASU as to which there is no approved generic or biosimilar. To put this number in perspective, FDA generally approves 30 to 40 new molecular entities every year, and more than 1,500 total have been launched in the U.S. market.[69] Further, it appears that generic and biosimilar companies have in fact been able to purchase the reference product in many of these instances. For instance, there are pending ANDAs for 10 of the 26 drugs.[70] Of the nine approved biologics that have REMS with ETASU, there is already a pending biosimilar application for one,[71] and readily available information indicates clinical trials of several others.[72] In the end, much of the public controversy seems to relate to only a few products—Thalomid®, Revlimid®, Tracleer®, and Letairis®—and there are pending generic applications citing these products.[73]

This is not to say that innovators always provide products to their competitors when requested; they have sometimes refused sale. In some situations, innovators have grounded their refusal in concerns that the requesting company did not have adequate safeguards in place to address the special risks presented by the drug in question.[74] FDA can provide a letter assuring the innovator that the generic applicant's bioequivalence study protocol contains safety protections comparable to the innovator's ETASU,[75] but it is not clear this letter provides the

(2)(A)(last sentence). For the sake of simplicity, I have omitted from discussion a third type of abbreviated application, filed under section 505(b)(2) of the FDCA.

66 42 U.S.C. §§ 262(i), 262(k).

67 *See* REMS@FDA. The agency maintains a spreadsheet of approved REMS, which can be downloaded.

68 *Id.*

69 Michael S. Kinch, *An overview of FDA–approved new molecular entities: 1827–2013*, 19 Drug Discovery Today (Aug. 2014) (concluding that FDA had approved a total of 1453 new molecular entities by the end of 2013); FDA, Novel Drug Approvals for 2014 and Novel Drug Approvals for 2015 (noting another 86 in 2014 and 2015 combined).

70 *See* Paragraph IV Certifications (Aug. 4, 2016).

71 *Pending Biosimilars*, The Pink Sheet (Mar. 7, 2016).

72 For example, Amgen is developing a biosimilar version of Soliris® (eculizumab). *See* Gareth MacDonald, *Amgen developing Soliris biosimilar*, BioPharma Reporter (June 21, 2016). To give another example, Merck was developing a biosimilar of Aranesp® (darbepoietin alfa) but reportedly stopped its program after FDA requested extensive cardiovascular outcomes data. *See*, e.g., NCT00968617 and NCT00924781 (clinicaltrials.gov identifiers for trials of MK2578 in comparison with Aranesp); *Merck's Ditching of Aranesp Biosimilar Highlights Follow–On–Biologics Pitfalls*, Seeking Alpha (May 16, 2010).

73 Dr. Reddy's filed a citizen petition in 2009 relating to purchase of Celgene's Revlimid. Docket No. FDA–P–0266. Lannett brought suit against Celgene in 2008 relating to purchase of Thalomid, and Mylan brought suit in 2014 relating to purchase of both products. Lannett Co., Inc. v. Celgene Corp., No. 08– cv–3920 (E.D. Pa. Aug. 15, 2008); Mylan Pharmaceuticals, Inc. v. Celgene Corporation, Case No. 2:14–CV–2094–ESMAH (D.N.J. Apr. 3, 2014).

In 2012, Actelion brought suit to establish that it had no obligation to sell Tracleer to generic applicants. Actelion Pharms. Ltd. v. Apotex, Inc., No. 12–cv–5743 (D.N.J. Sept. 14, 2012). In 2014, Natco brought suit against Gilead regarding purchase of Letairis. Natco Pharma Ltd. v. Gilead Sciences, Inc. and Express Scripts Holding Co., No. 14–cv–3247 (SD. Minn. Aug. 22, 2014). The court dismissed the complaint. *Court Dismisses Natco's REMS–Based Antitrust Suit*, BNA Pharmaceutical Law & Industry Report (Sept. 30, 2105).

The Mylan case is still pending; the other cases settled or were dismissed.

74 *See* Brief in Support of Defendant Celgene Corporation's Motion to Dismiss, Mylan v. Celgene (noting that the company had sold Thalomid to competitors that satisfied its "safety, reputational, business, and liability concerns").

75 *See* FDA, Draft Guidance for Industry, How to Obtain a Letter from FDA Stating that Bioequivalence Study Protocols Contain Safety Protections Comparable to Applicable REMS for RLD (Dec. 2014).

innovator with a defense in court if use of the innovator's product causes an injury. Consequently, an innovator might refuse sale if safety protocols do not seem adequate in its own judgment, if it lacks confidence in the competitor's commitment to the protocols, if it has doubts about the coverage of the competitor's liability insurance, or if it cannot agree to terms about liability. But it is not clear a reason is needed.[76] The Supreme Court wrote nearly 100 years ago that the antitrust laws generally protect the right of a manufacturer to decide with whom it will deal.[77] The Department of Justice and Federal Trade Commission cited this ruling as recently as August 2016, noting that "the antitrust laws generally do not impose liability upon a firm for a unilateral refusal to assist its competitors, in part because doing so may undermine incentives for investment and innovation."[78]

More significant than whether innovators may refuse to sell their products to competitors is whether lack of access to the reference product is truly an impediment to generic approval. Innovators stop marketing their products all the time and for all sorts of reasons. Since 1984, the generic drug provisions have contemplated the possibility that the reference product might have been withdrawn from the market, and FDA regulations dating to 1992 provide a mechanism for determining whether a product that is no longer commercially available may nevertheless serve as a reference product.[79] Typically in these situations, a generic applicant petitions FDA to determine whether the listed drug was withdrawn for reasons of safety or effectiveness. If the agency confirms that it was not withdrawn for those reasons, the generic applicant may cite the drug in its application. These petitions are commonplace, and FDA publishes its responses in the Federal Register. The agency sometimes adds that "future applicants are advised that they may not be able to obtain" the reference product, and any "ANDA applicant who is unable to obtain" the product "should contact the Office of Generic Drugs for a determination of what is necessary to show bioavailability and same therapeutic effect."[80] Sometimes it writes that applicants should "contact the Office of Generic Drugs for a determination of what showing is necessary to satisfy the requirements of section 505(j)(2)(A)(iv) of the act."[81]

FDA has thus indicated that it has the flexibility to work with generic applicants where the reference listed drug is no longer available. This is likely grounded in the agency's view that it has wide discretion with respect to the data needed to establish bioequivalence.[82] Although the statute requires proof of bioequivalence and defines the term, it does not specify how bioequivalence must be shown.[83] For instance, it might be possible to demonstrate that the rate and extent of absorption of the two drugs are identical by testing the proposed generic and comparing the results with robust published pharmacokinetic data on the reference drug. As the agency commented in response to a citizen petition ten years ago:

> It is well–accepted that FDA has wide discretion to determine how the bioequivalence requirement is met. FDA's discretion need only be based on a reasonable and scientifically supported criterion, whether [the agency] chooses to do so on a case–by–case basis or through more general inferences about a category of drugs.[84]

The agency's own regulations state that bioavailability or bioequivalence of a drug product may be determined using "[a]ny other approach deemed adequate by FDA to measure bioavailability or establish bioequivalence."[85]

Concerns relating to reference biological products may be more speculative than real at this point. To begin with, FDA has authorized applicants to perform at least some of the comparative testing with foreign versions of the reference product.[86] Biosimilar sponsors may be able to purchase some of

76 *See* Henry N. Butler, *REMS–Restricted Drug Distribution Programs and the Antitrust Economics of Refusals to Deal with Potential Generic Competitors*, 67 Fla. L. Rev. 977 (2015) (exploring antitrust jurisprudence in depth and suggesting that the antitrust claims involved do not provide a proper justification for a new exception to a competitor's right to refuse to deal); *but compare* Michael Carrier, et al., *Using Antitrust Law to Challenge Turing's Daraprim Price Increase*, 31 Berkeley Tech. L. J. __ (2016) (arguing that in the case of Daraprim, the elements of a monopolization claim under the Sherman Act—monopoly power and exclusionary activity—were established).

77 United States v. Colgate, 250 U.S. 300, 307 (1919).

78 U.S. Department of Justice and Federal Trade Commission, Antitrust Guidelines for the Licensing of Intellectual Property (Proposed Update, Aug. 12, 2016), at 13. Some of the support for the CREATES Act stems from this very fact—that antitrust law may not provide generic applicants with the relief they seek. One former FTC official testified in favor of the bill in June, supporting it in part because antitrust law has a "general presumption against requiring a firm to assist a competitor." Alden Abbott, *The CREATES Act: Ending Regulatory Abuse, Protecting Consumers, and Ensuring Drug Price Competition of 2016*, Testimony before the Subcommittee on Antitrust, Competition Policy, and Consumer Rights, Committee on the Judiciary, U.S. Senate (June 21, 2016), *available at* https://www.judiciary.senate.gov/imo/media/doc/06-21-16%20Abbott%20Testimony.pdf.

79 *E.g.*, 21 C.F.R. §§ 314.92(a)(1), 314.122.

80 *E.g.*, 79 Fed. Reg. 60852 (Oct. 8, 2014) (Lupron Depot); 79 Fed. Reg. 49327 (Aug. 20, 2014) (Lupron Depot–Ped); 76 Fed. Reg. 7219 (Feb. 9, 2011) (Decaspray); 71 Fed. Reg. 2047 (Jan. 12, 2006) (Celestone Soluspan); 75 Fed. Reg. 36419 (June 25, 2010) (Delalutin).

81 *E.g.*, 76 Fed. Reg. 7219 (Feb. 9, 2011); 75 Fed. Reg. 36419 (June 21, 2010); 71 Fed. Reg. 2047 (Jan. 12, 2006).

82 In a 2009 response to a citizen petition on this very issue, FDA noted its "considerable flexibility in determining the appropriate method" of showing bioequivalence. It added that "with limited exceptions, bioequivalence studies involve the potential applicant obtaining supplies of the RLD in order to conduct the required comparisons." FDA Citizen Petition Response, Docket FDA–2009–P–0266–0001 (August 7, 2013), at 4. This sentence seems to concede the legal and regulatory possibility of ANDA approval without use of the reference listed drug.

83 21 USC §§ 355(j)(2)(A)(iv) (requiring bioequivalence), 355(j)(8)(B) (defining it).

84 Letter from Janet Woodcock, Director, CDER, to Christopher V. Powala, CollaGenex Pharmaceuticals, Inc., Re: Docket Nos. 2003P–0315/CP1 and PSA1, 2003P–0372/CP1, and 2004P–0517/PSA1 (May 13, 2005), at 2, *citing* Bristol–Myers Squibb Co. v. Shalala, 923 F. Supp. 212, 218 (D.D.C. 1996) (*quoting* Schering v. Sullivan Corp., 782 F. Supp. 645, 651 (D.D.C. 1992), *vacated as moot sub nom*, Schering Corp. v. Shalala, 995 F.2d 1103 (D.C. Cir. 1993))).

85 21 CFR § 320.24(b)(6).

86 FDA, Guidance for Industry, Biosimilars: Questions and Answers Regarding Implementation of the Biologics Price Competition and

their needed supplies from foreign affiliates and subsidiaries of the U.S. license holders. Further, although the PHSA presumes that a biosimilar application will contain preclinical and clinical data, it authorizes FDA to waive any element of the application that is not "necessary" in the application.[87] The agency may have the flexibility to develop alternative approaches for applicants unable to acquire large supplies.

2. The CREATES Act's Proposed Cause of Action

Under the pending legislation, a generic or biosimilar applicant would be empowered to bring suit in federal court alleging that the innovator "declined to provide sufficient quantities" of the reference product on "commercially reasonable, market–based terms" within 31 days of request. There are two affirmative defenses: that the innovator does not manufacture, market, or have access to the product, or that the innovator has not imposed any restrictions on sale to generics and the product can therefore be purchased from distributors and wholesalers. Put another way, if the innovator manufactures and markets the product, it *must* sell the product to generic or biosimilar companies or permit its distributors to do so. If it refuses to sell the product, the court must order it to do so *and* award attorney's fees and costs to the complainant. Moreover, if the court concludes that the innovator acted "without a legitimate business justification," it must award the generic/biosimilar company "a monetary amount sufficient to deter the [innovator] from failing to provide . . . sufficient quantities" to other generic companies, up to the amount of all actual revenue from the reference product from 31–day mark to the day the product was actually provided. This cause of action is available whether or not the innovator's drug is under a REMS.

If the innovator holds patents claiming the drug or the method of manufacturing the drug, the court's order will require the company to practice its patent for the benefit of its competitor, even though it is a bedrock principle of U.S. patent law that a patent owner has no duty to practice its patent at all. As the Supreme Court wrote more than one hundred years ago, "it is the privilege of any owner of property to use or not use it, without question of motive."[88] Moreover, the duty to sell adequate amounts of one's product to one's competitors is, effectively, a duty to manufacture these amounts for the competitors. Assuming the innovator intends to continue supplying current patients with the medicine, it will have to make additional lots specifically for its competitors—for as many competitors as ask, for as many studies as are necessary to obtain approval, even if the competitors face regulatory obstacles and run their studies over and over, even if the competitors have significant compliance problems precluding application approval, and even if the product is protected by patent so that the generic applicant has no reasonable prospects of approval for years. In the case of a biological product, this could entail manufacturing enough product for several companies to run year–long trials in hundreds or thousands of patients. Absent a national defense emergency, however, it is hard to identify a compelling public policy justification for a law that effectively compels the manufacture of goods for sale.[89]

C. Second Complaint: Sharing of System to Implement REMS–with–ETASU

If a reference listed drug has ETASU under a REMS, federal law generally requires that the innovator and generic companies use a "single, shared system" to implement the restrictions.[90] In these situations, all companies work with the same REMS documents, tools, and procedures. This requirement applies only to generic drugs, however, not to biosimilar biologics.

1. Inability to Reach Agreement on a Shared System

The statute allows FDA to waive the requirement of a "single, shared system" for any generic applicant, if the burden of creating the shared system outweighs the benefit of creating a shared system, taking into account the impact on the generic drug applicant and the innovator (new drug application—or NDA—holder), among others.[91] The agency may separately waive the requirement for a generic applicant if an aspect of the restrictions is protected by patent or is trade secret.[92] The generic company must ask for a license first, and FDA may try to negotiate a voluntary agreement between the innovator and the generic company.[93] But the statute *expressly* contemplates the possibility that a shared system might unduly burden the generic applicant. This might be true, for instance, if arm's length negotiations did not result in terms that were acceptable to the generic applicant. Moreover, that the NDA holder holds intellectual property in its REMS is a *separate* reason to excuse the generic applicant from the obligation to use a shared system, presumably reflecting the fundamental rule that a property owner may lawfully choose not to license or share its property at any price. In either case, FDA is free to relieve the generic applicant of the presumptive obligation to use the NDA holder's system.

The complaint that a particular innovator will not agree to a "single, shared system" for implementation of use and

Innovation Act of 2009 (April 2015), at 8.

87 42 U.S.C. § 262(k)(2)(A)(ii).

88 Continental Paper Bag Co. v. Eastern Paper Bag Co., 210 U.S. 405, 429 (1908). A ruling from the Second Circuit in 2015 departed sharply from the well–established principle that a patent owner has an unfettered right to make (or not make) and sell (or not sell) its invention and from the guidance in the Patent Act, 35 U.S.C. § 271(d)(4), that refusal to make a patented product should not give rise to antitrust liability. New York ex rel. Schneiderman v. Actavis PLC, 787 F.3d 638 (2d Cir. 2015) (affirming injunction that required pharmaceutical company to continue manufacturing and distributing its patented product for an additional 238 days, so that in the final 30 days patients would receive the generic by virtue of state automatic substitution laws).

89 The Defense Production Act of 1950 empowers the President to compel manufacturers to perform contracts deemed necessary to the national defense. 50 U.S.C. § 2071.

90 21 U.S.C. § 355–1(i)(1)(B); FDA, Guidance for Industry, Risk Evaluation and Mitigation Strategies: Modifications and Revisions (Apr. 2015).

91 21 U.S.C. § 355–1(i)(1)(B).

92 *Id.*

93 *Id.*

distribution restrictions is therefore, at bottom, a complaint that the negotiation did not go favorably for the generic applicant, or that the innovator declined to license its property to the generic applicant. Because FDA has explicit authority to approve a generic drug with a use and distribution system of the generic company's own creation, however, this complained–of situation has no legal significance. Put another way, there is no legal impediment to approval of the generic drug. As a matter of public policy, we may well prefer shared distribution systems because they are more efficient, or less confusing to third parties, or for other reasons. This could provide good reason to consider incentivizing the companies to find agreeable terms. But the law is clear that FDA may approve generic drugs with their own systems.

Further, there is no reason to think that generic applicants are unable to design and support REMS, including with use and distribution restrictions. Many generic companies today also market innovative products under NDAs and have the resources and experience to design sophisticated risk assessment and risk mitigation programs. FDA has already approved a separate REMS. Roxane Laboratories has a REMS, with use and distribution restrictions, in connection with its generic alosetron product.[94] This includes the company's own Patient Acknowledgment Form, Patient Follow–Up Survey, program stickers (for affixing to written prescriptions), Prescriber Enrollment materials (letter, form, education slide deck), a special website, and a database for certified enrolled prescribers. The reference listed drug, Lotronex, originally developed by GlaxoSmithKline, is now marketed by Sebela Pharmaceuticals under its own REMS and implementation system.[95] FDA also granted a waiver in connection with Suboxone® (buprenorphine hydrochloride; naloxone hydrochloride) when the innovator and generics could not reach agreement.[96]

2. The CREATES Act's New Cause of Action

Under the pending legislation, a generic applicant could bring suit in federal court alleging that the innovator failed to reach an agreement with it regarding a single, shared system of use and distribution restrictions. The new cause of action is also available to biosimilar applicants, even though neither the FDCA nor the PHSA suggests that biosimilar biologics and their reference products should have single, shared systems in the first instance. There are no affirmative defenses.

As a result, liability would follow provided the applicant "initiated an attempt" to negotiate terms, 120 days passed without any agreement reached, and the agency did not waive the requirement for a shared system. The applicant would have no obligation to ask for a waiver, however, and FDA would have no obligation to grant one. As a practical matter, therefore, the bill would entitle a generic or biosimilar applicant to a court order requiring an innovator to agree to a shared system or use of the innovator's own system on what the court determines to be "commercially reasonable terms" (as opposed to negotiated terms). It also entitles the applicant to attorney's fees and costs. If the court concluded that the innovator had declined to agree "without a legitimate business justification," it would award the generic or biosimilar company a "monetary amount sufficient to deter the [innovator] from failing to reach agreements" with other companies, up to the amount of all actual revenue from the reference product from the 121–day mark to the day the agreement was actually reached.

If the innovator owned patents or other intellectual property in connection with the program it had established, the court order would effectively require it to share the intellectual property with its competitors. It would no longer be possible for arm's length negotiations to result in a realization that no set of terms was mutually agreeable. Depending on the nature of the program and the nature of the intellectual property, therefore, the innovator might be required to practice the patent for the benefit of its competitors, or it might be required to license the patent for the competitor's use, on terms of the court's choosing.

III. Consequences and Implications

At first blush, this bill seems to steer private parties towards use of the courts to achieve their business goals. As noted in the prior section, there might be good reason to incentivize innovators and generic/biosimilar companies to find mutually agreeable terms for shared distribution systems. Rather than incentivizing agreements, however, the bill makes the negotiation phase perfunctory at best and may encourage generic and biosimilar applicants to negotiate in bad faith, as explained below.

First, it is unrealistic to think that 31 days would be enough time to negotiate all terms relevant to sale of a restricted product for analytical and clinical testing (and to deliver all of the product needed, which is also required under the plain terms of the bill). To begin with, the parties would need to settle on basic contractual terms (quantities, time and place of delivery, and consideration). They would need to discuss essential matters such as the adequacy of the applicant's safety protocols and the handling of liability in the event a subject in the trial experienced an injury (including a process for determining whether the applicant's protocol, or compliance with that protocol, was to blame). The innovator might want to address the risk of shareholder suits—perhaps grounded in having shared its product too hastily or without adequate assurances of liability protection—in the event of product liability exposure. Unexpected events during the applicant's studies could raise new questions about the product's risk–benefit profile, and the innovator might need the agreement to address how those questions would be explored. A mutually satisfactory deal might

94 REMS, Alosetron Tablets (Mar. 2016).

95 REMS, Lotronex (Apr. 2016).

96 *Compare* REMS, Suboxone (July 2016) *with* REMS, Buprenorphine–containing Transmucosal Products for Opioid Dependence (July 2016); FDA, Citizen Petition Response, Docket No. FDA–2012–P–2028 (Feb. 22, 2013) at 12 n.45 (noting waiver). Negotiations apparently failed when the innovator requested that the generic companies (1) commit to patient safety; (2) agree to cost–sharing; and (3) agree to sharing of product liability costs. *See* Comments of Amneal Pharmaceuticals, Docket No. FDA–2012–P–1028 (Feb. 4, 2013), at 4 n.3 (listing the terms requested by the innovator).

never be reached, and a mutually satisfactory deal within 31 days might be impossible.

So too with the 120 days to develop a shared REMS for the innovative drug and its generic equivalents. This misunderstands the complexity of the process.[97] Typically, more than one generic applicant submits an ANDA referring to a particular innovative product. The innovator and generic companies form a working group that develops the new shared REMS, which means developing and sharing responsibility for every aspect of the REMS. Consider, by way of illustration, the REMS shared by nine companies marketing clozapine to address the risk of low absolute neutrophil count (ANC).[98] These companies agreed to roughly 250 pages worth of common documents (REMS, patient enrollment form, two different pharmacy enrollment forms, two prescriber enrollment forms, knowledge assessment for healthcare providers, guide for healthcare providers, and ANC lab reporting form). They share responsibility for ensuring that healthcare providers and pharmacies are certified; for maintaining validated secure databases of certified healthcare providers, enrolled patients, and certified pharmacies; for ensuring that certified prescribers have access to the databases of certified pharmacies and enrolled patients; and for ensuring that distributors have processes and procedures to verify pharmacy certification. They share responsibility for monitoring distribution data, and auditing wholesalers, distributors, and pharmacies. They maintain a single contact center to support prescribers and pharmacies, and they maintain a shared REMS website. In short, a group of companies that may have diverging business models and different levels of risk tolerance must work out a wide range of issues, from the actual procedures and tools used and the content of all written materials, to cost–sharing (with attendant contractual complications, such as how cost will be determined, how the sharing will be allocated, and how disputes will be handled), insurance, and liability. A deadline for this process that is both arbitrary and unrealistic sends a clear signal that the negotiation phase is a sham.

Second, even if negotiation on these timetables were realistic, generic and biosimilar applicants are given no incentive to negotiate in good faith. The bill imposes on innovators the obligation to manufacture and sell their products to their competitors in every case without exception or defense, as well as the obligation to reach agreement on a shared REMS (or share their own REMS) in every case without exception or defense. And the remedies provided are mandatory. If a court will in every case order the innovator to provide "sufficient quantities" of the product "without delay" and on "commercially reasonable, market–based terms"—and order the innovator to negotiate a shared system or share its own system "on commercially reasonable terms"—there is no reason for a generic or biosimilar applicant to attempt negotiation before going to court. Further, the penalty provision may encourage unscrupulous companies to stonewall even where the innovator offers terms that are reasonable. After all, if the court concludes that the innovator's refusal lacked "legitimate business justification," it will award to the generic company all of innovator's revenue on the product from the deadline (day 31 or 121) until the day the innovator complies with the court's mandate. The revenue for the generic company during this time—actual revenue from all of the innovator's sales of the product in question—could significantly exceed any revenue the generic company could realize from an eventual approved product. It is not unreasonable to worry that unprincipled companies might seek to delay judicial proceedings to extend that financial windfall.

All of this said, the court cases may be a red herring. Although some innovators may stand their ground and litigate, the design of the bill suggests it is not really intended to shift responsibility to the courts. In fact, the bill may discourage litigation. Take the cause of action for manufacture and delivery of products, for instance. As noted, from the perspective of a generic or biosimilar applicant, there is no reason to negotiate in good faith, because a court order with attorney's fees is assured, and an award of innovator revenues is possible. From the perspective of an innovator, proceeding to court means a federal judge will decide the quantities of product that are "sufficient" for its competitor, as well as the timing for delivery and the terms that are "commercially reasonable" and "market–based." The statute does not define these phrases, leaving a wide range of outcomes possible.[99] Proceeding to court may also mean loss of all revenue from the product in question, if the judge determines the innovator lacked a "legitimate business justification" for its position in the negotiations—another phrase that is left to the courts to interpret.

Thus, the basic approach of the bill is to incentivize the generic applicant to refuse terms offered by the innovator, while threatening the innovator with unpredictable penalties for failing to agree to terms requested by the generic applicant. It is not unreasonable to expect innovators to agree to almost any terms suggested, and generic companies to refuse almost all terms proposed. The legislation may force innovators into acceding to unreasonable demands at the outset. An innovator would proceed to court, presumably, only if the deal requested by the generic company was *worse* that whatever rate a hostile court would set, plus all of the company's revenue for the interim period. This potential outcome is profoundly troubling, given the strong possibility that, in refusing sales, innovators are acting in full compliance with antitrust law.[100]

IV. Conclusion

The CREATES Act has gained traction this year in part because some supporters have linked it to the pricing

97 For a description, see generally FDA, Citizen Petition Response, Docket No. FDA–2013–P–0572 (Oct. 7, 2013), at 5–6.

98 *See generally* Clozapine Shared System REMS (Sept. 15, 2015).

99 Indeed, there might not be "commercially reasonable, market–based terms" for directly assisting one's competitors.

100 An NDA holder may not "use" an ETASU to "block or delay" approval of an ANDA or to prevent "application" of an element in an ETASU to the generic drug in question. 21 U.S.C. § 355-1(f)(8). FDA can enforce this prohibition through civil money penalties. *Id.* § 333(f)(4)(A). There is no evidence in the statute or legislative history, however, that Congress meant to override the bedrock principle of antitrust law that a company has no duty to deal with its competitor, or the bedrock principle of patent law that a company has no duty to practice its patent. Indeed, there is evidence to the contrary. Congress rejected earlier proposals that would

controversy associated with Martin Shkreli and his company, Turing Pharmaceuticals. In August 2015, Turing acquired the rights to a decades–old, off–patent drug for toxoplasmosis, Daraprim® (pyrimethamine). Turing maintained a closed distribution system that had been established in June 2015, and it increased the price from $13.50 per tablet to $750 per tablet.[101] The distribution program was not linked to any particular safety issue, however, and company documents suggested it was intended specifically to "create a barrier and pricing power."[102] Outrage over the price increase, and Shkreli's seeming indifference to criticism, took over mainstream media and social media for months. Although earlier bills addressing REMS predated the Daraprim controversy, the incident now features prominently in discussion of the legislation.

The problem is that it is analytically unsound to equate Daraprim—a drug without significant safety concerns—with drugs like Thalomid and Adempas, which present serious risks of embryo–fetal toxicity, which are subject to FDA–mandated distribution restrictions because of (and tailored to reduce) those risks, and which are associated with intellectual property.[103] While the legislation would have forced Shkreli to sell his product to aspiring generic applicants, the drug had been marketed since the 1950s, and there had not previously been significant interest in generic applications. Had Shkreli not also increased the price, it is unlikely there would have been any meaningful interest in generic applications in 2015. The *real* issue with Daraprim was the sudden and dramatic price hike, coupled with Shkreli's combativeness. Deep frustration with the cost of medicine in this country cannot, however, justify a failure to differentiate analytically between Turing Pharmaceuticals and the research–based, innovating biopharmaceutical industry. The cost of innovation is a period of high prices without competition; that is the nature of intellectual property. The intellectual property clause of the original U.S. Constitution of 1788 enshrines the bargain that we make as a society: protection of exclusive rights for limited times, with all this entails, in order to ensure continuing progress and innovation.[104] While the cost of innovation may be frustrating at times, it is exceptionally short sighted to direct this frustration towards companies that are developing new medicines, own intellectual property, and have a right to choose with whom they will do business.

have imposed a duty of sale. *E.g.*, H.R. 2900, 110th Cong. § 901 (2007). And the statute plainly contemplates the possibility that a deal cannot be reached on a shared system.

101 *See* Andrew Pollock, *Drug Goes From $13.50 a Tablet to $750, Overnight*, The New York Times (Sept. 20, 2015).

102 *See* Memorandum to Democratic Members of the Full Committee, from Democratic Staff, re: Documents Obtained by Committee from Turing Pharmaceuticals (Feb. 2, 2016), at 3.

103 The vast majority of the 35 products under REMS–with–ETASU are protected by data exclusivity, patents, or both. Of the 35 innovative products under REMS–with–ETASU, six of the nine biologics have unexpired data exclusivity, seven of the 26 drugs have unexpired new chemical entity exclusivity, four of the latter also have orphan drug exclusivity, and several other drugs have three–year exclusivity. All but four of the drugs have patents listed in the Orange Book. *See* Approved Drug Products with Therapeutic Equivalence Evaluations (36th ed., 2016); List of Licensed Biological Products with Reference Product Exclusivity and Biosimilarity or Interchangeability Evaluations (CDER List, Aug. 30, 2016).

104 U.S. Const. Art. I, § 8, cl. 8.

Intellectual Property and Standard Setting

By Koren W. Wong-Ervin and Joshua D. Wright

Note from the Editor:

This article discusses the controversial topic of intellectual property in standard setting.

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I. Introduction

"Standards enable virtually all the products we rely upon in modern society, including mechanical, electrical, information, telecommunications, and other systems, to interoperate."[1] Standards reside at the heart of, among other things, the mobile industry, allowing users to experience worldwide interoperability and interconnectivity across mobile devices. If the mobile industry lacked standards, you might enjoy your iPhone but be unable to call your friend on his Galaxy due to incompatible technology.

Standard setting has become increasingly important to the economy. Voluntary, open, and market driven standard setting promotes research and development investments in "best of generation" technologies that enable and accelerate follow-on innovation, competition, and economic growth. Standard-development organizations (SDOs) are private organizations that develop technical and other standards through a collaborative and consensus-driven process that balances the varied interests of industry participants, which include both producers and potential users of technology. SDOs provide a platform for industry scientists and engineers to come together and develop technical standards. Because standards may include technology that is the subject of intellectual property rights (IPRs) such as patents, SDOs historically have promoted widespread dissemination of standardized technologies through IPR Policies, which balance the rights of IPR holders with rights to access essential technology. Although SDO IPR Policies vary widely, many policies achieve this balance by seeking to have their members publicly declare any potential standard-essential patents (SEPs) (i.e., patents that are essential to practice a given standard) and to license them on "fair, reasonable, and nondiscriminatory" (FRAND) terms.[2] Most SDOs clearly state that the purpose of the FRAND assurance is to both ensure access to the standardized technology and fairly compensate the contributors to the standard.[3]

The issues and choices regarding specific IPR Policies are best left to individual SDOs and their members to decide, rather than government agencies. SDOs "vary widely in size, formality, organization and scope,"[4] and therefore individual

1 Note by the United States, *Intellectual Property and Standard Setting*, OECD at 3 (Dec. 2014), http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD(2014)116&doclanguage=en.

2 *See, e.g.,* Joanna Tsai & Joshua D. Wright, *Standard Setting, Intellectual Property Rights, and the Role of Antitrust in Regulating Incomplete Contracts*, 80 Antitrust L.J. 1 (2015) [hereinafter Tsai & Wright].

3 For example, the European Telecommunications Standards Institute (ETSI) states that the purpose of its policy is to "reduce the risk . . . that investment in the preparation . . . of standards could be wasted as a result of an essential IPR . . . being unavailable" and also that "IPR holders . . . should be adequately and fairly rewarded for the use of their IPRs." ETSI Intellectual Property Rights Policy § 3.1–3.2 (Eur. Telecomms. Standards Inst. 2014), http://www.etsi.org/images/files/IPR/etsi-ipr-policy.pdf. *See also* Anne Layne-Farrar, *The Economics of FRAND*, *in* Antitrust Intellectual Property and High Tech Handbook 1, 13 (Daniel Sokol ed., 2016) [hereinafter Layne-Farrar].

4 U.S. Dep't of Justice & Fed. Trade Comm'n, Antitrust Enforcement and Intellectual Property Rights: Promoting

SDOs may need to adopt different approaches to meet the specific needs of their members. A government agency's issuance of recommendations may unduly influence private SDOs and their members to adopt policies that might not otherwise gain consensus support within a particular SDO and that may not best meet the needs of that SDO, its members, and the public. This could occur because the SDO believes that failing to adopt the specified policy is not permitted or because failing to adopt the policy could subject the SDO and its members to other legal liabilities.[5] Accordingly, the U.S. Antitrust Agencies have taken the position that they do "not advocate that SSOs [standard setting organizations or SDOs] adopt any specific disclosure or licensing policy, and the Agencies do not suggest that any specific disclosure or licensing policy is required."[6]

However, despite these statements, the U.S. Department of Justice's Antitrust Division (DOJ) recently issued a Business Review Letter on the proposed amendments to the Institute of Electrical and Electronics Engineers, Incorporated's (IEEE's) IPR Policy.[7] In the letter, the DOJ went well beyond its mission of providing a statement of its antitrust enforcement intentions with respect to the proposed amendments, and instead endorsed certain policy choices. Some of its preferred policies include provisions that essentially prohibit patent holders from seeking or enforcing injunctive relief on FRAND-assured SEPs, and provisions that essentially require component-level licensing; the latter is contrary to the long-standing industry practice of end-user device licensing. The IEEE's controversial amendments were highly criticized by SEP holders and others on both procedural and substantive grounds.[8] Recent econometric analysis reveals a biased treatment of substantive comments submitted to the IEEE by members opposed to the controversial revisions. Additional empirical evidence following the amendments shows a slowed rate of development for IEEE standards and numerous major SEP holders refusing to grant letters of assurance (i.e., assurances to license under certain terms) under the new policy.[9]

Another concerning development is the U.S. Federal Trade Commission's (FTC's) recent consent agreements with Bosch and Motorola Mobility/Google. The former prohibits the company from seeking or enforcing injunctive relief on FRAND-assured SEPs; the latter prohibits the companies from seeking injunctive relief on a *worldwide* basis except under certain circumstances. Following the FTC's consent agreements, antitrust agencies around the world, including in Canada, China, Korea, and Japan, adopted similar approaches, namely creating competition law sanctions for seeking or enforcing injunctive relief against "willing licensees." These developments represent a fundamental policy shift that threatens to disrupt the carefully balanced FRAND ecosystem without any evidence that the targeted conduct (namely "holdup" by patent holders) is a widespread or systemic problem that has led to higher prices, reduced output, or lower rates of innovation. Indeed, in contrast to the predictions of the theories that such injunctions will have anticompetitive effects, products that intensively use SEPs have seen robust innovation as well as falling prices and increased output when compared to industries that do not rely upon SEPs.

II. The Economics of IP and Standard Setting

The economic issues which arise in the context of IPRs in SDOs are related to the broader policy debate about IPRs. The incentive function of IP is illustrated by considering the sale of an invention in the absence of enforceable IPRs. The sale of an invention requires disclosure to the potential buyer. In the absence of enforceable IPRs, the potential buyer—now with knowledge of the invention—has no incentive to purchase or license the invention. This possibility deters the seller from disclosing the invention in the first place. Enforceable property rights solve this problem by allowing the seller to disclose the invention without fear that it will be appropriated without compensation or possibility of legal redress. The inventor can anticipate the ability to appropriate the returns from investment

Innovation and Competition 33 n.5 (2007), http://www.ftc.gov/sites/default/files/documents/reports/antitrust-enforcement-and-intellectual-property-rights-promoting-innovation-and-competition-report.s.department-justice-and-federal-trade-commission/p040101promotinginnovationandcompetitionrpt0704.pdf [hereinafter 2007 IP Report].

5 Comment of the Global Antitrust Institute, George Mason University School of Law, on the India Department of Industrial Policy and Promotion's Discussion Paper on Standard Essential Patents 8–9 (Mar. 31, 2016), http://masonlec.org/site/rte_uploads/files/GAI%20DIPP%20Comments%20%28India%20SEP%20Paper%29_3-31-16_Final.pdf.

6 2007 IP Report, *supra* note 4, at 48.

7 Letter from Renata B. Hesse, Acting Assistant Attorney Gen., U.S. Dep't of Justice, to Michael A. Lindsay, Dorsey & Whitney LLP (Feb. 2, 2015), https://www.justice.gov/sites/default/files/atr/legacy/2015/02/02/311470.pdf [hereinafter 2015 IEEE Business Review Letter].

8 *See, e.g.*, Letter from Lawrence F. Shay, Exec. Vice President of Intellectual Prop., InterDigital, Inc., to David Law, Patent Comm. Chair, IEEE-SA Standards Bd. (Mar. 24, 2015), http://wpuploads.interdigital.com.s3.amazonaws.com/uploads/2015/03/Letter-to-IEEE-SA-PatCom.pdf ("InterDigital will not make licensing assurances under the new policy; and will instead make alternative licensing assurances, on a case-by-case basis, that are consistent with the goals of driving technology adoption while ensuring fair compensation for research success."); Letter from Gustav Brismark, Vice President, Strategy & Portfolio Mgmt., Ericsson AB, to Eileen M. Lach, Gen. Counsel & Chief Compliance Officer, IEEE (Oct. 21, 2014), http://www.mlex.com//Attachments/2015-10-26_5P338037F7HPVP5L/rand-terms.pdf ("Consequently, it appears that, moving forward, Ericsson would not be able to submit any [Letters of Assurance] under the terms of the proposed new IEEE-SA policy."); Letter from Irwin Mark Jacobs, Founding Chairman & CEO Emeritus, Qualcomm, to Dr. Roberto Boisson de Marca, President & CEO, IEEE (Nov. 19, 2014), http://www.advancingengineering.org/irwin-jacobs. *See also* Letter from Sen. Christopher A. Coons, U.S. Senator, to Hon. Eric Holder, Attorney Gen., U.S. Dep't of Justice, and Hon. William J. Baer, Assistant Attorney Gen., U.S. Dep't of Justice (Jan. 14, 2015), http://ipwatchdog.com/materials/1-14-2015-Coons-IEEE.pdf.

9 Letter from Lawrence F. Shay to David Law, *supra* note 8; Letter from Gustav Brismark to Eileen M. Lach, *supra* note 8; Letter from Irwin Mark Jacobs to Dr. Roberto Boisson de Marca; *supra* note 8. *See also* Ron D. Katznelson, Presentation at IEEE GLOBECOM 2015: Decline in Non-Duplicate Licensing Letters of Assurance (LOAs) from Product/System Companies for IEEE Standards (updated Mar. 30, 2016), https://works.bepress.com/rkatznelson/80/ (noting the decline in letters of assurance under new IEEE patent policy).

in producing the invention, which serves as an incentive to both invest in producing the invention and to disclose it.[10]

The economic literature also discusses the optimal tradeoff between these incentives and the ability to use the invention.[11] Because inventions and works protected by IPRs are non-rivalrous, one firm using a specific IPR does not diminish the ability of another firm to use the same IPR. Also, the cost of having another firm use an existing IPR is effectively zero. As a consequence, from a *static* welfare perspective, it is desirable to disseminate IPRs to every firm (or consumer) that has a positive valuation for the IPR. Of course, doing so would create a strong disincentive to innovate in the first place, to the great detriment of *dynamic* efficiency, which refers to the gains that result from entirely new ways of doing business. While static efficiency may increase consumer welfare in the short run, economics teaches that dynamic efficiency, including societal gains from innovation, are an even greater driver of consumer welfare.[12]

After the investments of time, money, and competitive effort required to spur breakthrough inventions have already been made and proven successful, it can be tempting to carve up the benefits and distribute them throughout the economy. Doing so, however, would harm competition, innovation, and consumers in the long run. If the government has demonstrated that it is too willing to step in and appropriate the gains from innovation and dynamic competition, then potential innovators anticipating such interventions will have weak incentives to risk investment in new inventions. In addition, the costs of Type I errors (i.e., false positives) leading to a chilling of procompetitive innovation are significant.[13]

With respect to standard setting in particular, the economic goals are complex and involve important benefits and costs. Two primary types of standards are those that set minimum performance levels and those that guarantee interoperability. The former type of standard often serves to inform consumers and facilitate quality assurance by ensuring that products meet a minimum level of performance or quality. Interoperability standards guarantee that products made by different companies are compatible with other products that incorporate the standard, generating significant consumer benefits when the standard is widely adopted. Interoperability can also reduce the costs of production by reducing firms' costs of acquiring technical information, thus simplifying both the design and production of products that incorporate the standard. The benefits of interoperability are magnified in "network" markets, where the value of a product or service to an individual consumer is dependent upon the total number of consumers that adopt compatible products. On the other hand, adoption of uniform standards can have potential costs. In the absence of property rights to technology included in standards, the adoption of a uniform standard may create incentives for free riding and suppress incentives for firms to improve on the current standard or create alternative standards. As a result of these effects, individual firms' choices to adopt competing proprietary standards using incompatible technology may increase welfare relative to use of a mandated standard. This result highlights the importance of IPRs to standards, namely that the absence of IPRs for standard technologies can lead to the underproduction of those technologies and may deter investment in research and development and reduce the quality of the final product.[14]

Lastly, competition among rival SDOs and their proprietary standards reflects the features of a two-sided market, where SDOs serve as platforms to join together contributors and adopters of technology protected by IPRs. SDOs must adopt policies that are attractive to both contributor and adopter members. All else being equal, an SDO is more attractive to a technology contributor with a larger base of adopters. As a multi-sided platform, a successful SDO will attract members on both sides by striking a balance between the two sides with respect to its rules and policies. The contract terms optimizing this balance will vary between and within SDOs as technology, regulatory, and market conditions facing the organization change over time.[15]

III. IEEE Amendments, the DOJ's Business Review Letter, and the Aftermath of the IEEE's Amendments

In 2015, the IEEE proposed significant amendments (which it referred to as mere "updates" or "clarifications") to its IPR Policy. The amendments raised a number of process concerns over revisions that, among other things, would severely limit an SEP holder's ability to seek or enforce injunctive relief and impose numerous conditions on arms-length royalty negotiations. These limits on negotiations would include essentially requiring that an SEP holder license on a component-level basis as opposed to the end-user-device level. Prior to the IEEE amendments, no SDO explicitly addressed injunctive relief.[16]

One recent empirical study analyzing public data finds "a biased treatment of substantive comments submitted to the IEEE by members opposed to the controversial revisions."[17] Sixteen companies submitted 680 comments on four drafts

10 Comment of the Global Antitrust Institute, George Mason University School of Law, on the National Development and Reform Commission's Anti-Monopoly Guide on Abuse of Intellectual Property Rights 1-3 (Nov. 12, 2015) [hereinafter GAI Comment to NDRC], http://masonlec.org/site/rte_uploads/files/GAI%20NDRC%20Comment_11-12-15_FINAL.pdf.

11 Bruce H. Kobayashi & Joshua D. Wright, *Intellectual Property and Standard Setting*, *in* ABA Handbook on the Antitrust Aspects of Standards Setting (2010) [hereinafter Kobayashi & Wright].

12 Robert Solow won the Nobel Prize in economics for demonstrating that gains in wealth are due primarily to innovation—not to marginal improvements in the efficiency of what already exists. *See* Press Release, The Royal Swedish Academy of Sciences (Oct. 21, 1987), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1987/press.html.

13 GAI Comment to NDRC, *supra* note 10, at 1–3.

14 Kobayashi & Wright, *supra* note 11, at 3–4.

15 Tsai & Wright, *supra* note 2, at 165–66.

16 *See, e.g.*, Layne-Farrar, *supra* note 3, at 13.

17 J. Gregory Sidak, *Testing for Bias to Suppress Royalties for Standard-Essential Patents*, 1 Criterion J. Innovation 301 (2016), https://www.criterioninnovation.com/articles/sidak-bias-to-suppress-sep-royalties.pdf.

of the proposed amendments and to drafts of a supporting informational document. An ad hoc committee, which IEEE's Patent Committee entrusted with the drafting and development of the 2015 amendments, collected and responded to the suggested revisions. The analysis reveals that "the ad hoc committee at a substantially higher rate rejected comments by companies that opposed or were neutral towards the proposed changes."[18] The study also says that empirical analysis "indicated a strong negative correlation between an IEEE member's status as an SEP holder and the IEEE's propensity to accommodate that member's input in the development" of the amendments, and that the "ad hoc committee was significantly more likely to reject comments from SEP holders when those comments addressed certain controversial provisions" of the amendments.[19]

Despite this evidence, on February 2, 2015, the DOJ issued a favorable Business Review Letter on the amendments, rejecting concerns about process. The letter concluded that "it appears that the overall process afforded considerable opportunity for comment on and discussion of the Update" and noted that "[t]here were numerous opportunities for presenting divergent views as part of the multi-level review process."[20]

The DOJ's letter also endorses the IEEE's policy decision on the grounds that the "clarification" is procompetitive, although it presents no evidence that this is the case. In several places throughout the letter, including with respect to the smallest saleable patent practicing unit (SSPPU) approach, the DOJ claims the IEEE's revisions were "consistent with the direction of U.S. law." These claims are dubious. For example, as the U.S. Court of Appeals for the Federal Circuit recently explained in *Ericsson v. D-Link*, the SSPPU approach was not a substantive doctrine but rather was created as an evidentiary rule "to help our jury system reliably implement the substantive statutory requirement of apportionment."[21] The court went on to explain that, "[l]ogically, an economist could do this [apportionment] in various ways—by careful selection of the royalty base to reflect the value added by the patented feature, where that differentiation is possible; by adjustment of the royalty rate so as to discount the value of a product's non-patented features; or by a combination thereof."[22] Moreover, there are a number of considerations that may dictate the parties' selection of a royalty base in a freely negotiated license agreement. Industry practice and the convenience of the parties are two such considerations; other commercial dealings between the parties may also affect their negotiation. In order to reduce administrative costs, a royalty base is often selected to allow for easy monitoring or verification of the number of units sold; end product prices are often chosen for these reasons.[23]

Although the DOJ acknowledges in its letter that "[i]t is unlikely that there is a one-size-fits-all-approach for all [SDOs], and, indeed, variation among [SDOs'] patent policies could be beneficial to the overall standards-setting process,"[24] the letter has been widely relied upon, particularly by foreign jurisdictions, to support excessive pricing prohibitions based on charging for the end-user device[25]—something the SSPPU approach was never intended for.

Evidence following the amendments shows a slowed rate of development for IEEE standards and numerous major SEP holders refusing to grant letters of assurance under the new policy.[26]

IV. FTC Actions Regarding Injunctive Relief

The FTC does not merely argue against the use of injunctive relief; it uses its enforcement actions to limit companies' ability to seek it. Consider two recent enforcement actions by the agency. In 2013, the FTC entered into a consent agreement in *Bosch*, prohibiting the company from seeking or enforcing injunctive relief on FRAND-assured SEPs under Section 5 of the FTC Act.[27] Similarly, in 2014, the FTC entered into a consent order with Motorola Mobility and Google prohibiting the companies from seeking injunctive relief on a worldwide basis except under certain circumstances, such as when the accused infringer is an "unwilling licensee."[28] In particular, the FTC alleged that Google breached its FRAND commitment by using threats to enjoin and exclude implementers of its SEPs in order to enhance its bargaining leverage against its willing licensees.[29] Taken together, these actions necessarily depend upon the FTC's presumption that protecting a valid

18 *Id.* at 303; *see also id.* at 322–24.

19 *Id.* at 303–04; *see also id.* at 325–31.

20 2015 IEEE Business Review Letter, *supra* note 7.

21 Ericsson, Inc. v. D-Link Sys., Inc., 773 F.3d 1201, 1227 (Fed. Cir. 2014).

22 *Id.* at 1226.

23 *See* Anne Layne-Farrar & Koren W. Wong- Ervin, *An Analysis of the Federal Circuit's Decision in* Ericsson v. D-Link, CPI Antitrust Chronicle (Mar. 2015), http://www.crai.com/sites/default/files/publications/An-Analysis-of-the-Federal-Circuits-Decision-in-Ericsson-v-D-Link.pdf [hereinafter Layne-Farrar & Wong-Ervin].

24 2015 IEEE Business Review Letter, *supra* note 7, at 2.

25 *See generally* Matthew Newman, *Antitrust Agencies Should be Wary of "Excessive Pricing" Cases in Patent Disputes, Hesse Says*, MLex (June 17, 2015) (quoting then-Deputy Assistant Attorney General Renata Hesse, "We really believe the business review letter itself should not set an example for other parts of the world to take action and to suggest that excessive pricing somehow violates the antitrust law.").

26 *See, e.g.*, Katznelson, *supra* note 9.

27 Decision and Order, *In the Matter of Robert Bosch GmbH*, Docket No. C-4377 (Apr. 23, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/04/130424robertboschdo.pdf.

28 Decision and Order, *In the Matter of Motorola Mobility LLC, and Google Inc.*, Docket No. C-4410, at 7–8 (July 23, 2013), http://www.ftc.gov/sites/default/files/documents/cases/2013/07/130724googlemotorolado.pdf.

29 Complaint, *In the Matter of Motorola Mobility LLC, and Google Inc.*, Docket No. C-4410, at 5 (Jan. 3, 2013), https://www.ftc.gov/sites/default/files/documents/cases/2013/01/130103googlemotorolacmpt.pdf.

FRAND-assured SEP against infringement by seeking injunctive relief is itself anticompetitive.

It is important to note that these were negotiated consents under the FTC's standalone Section 5 unfair methods of competition authority, not based upon traditional U.S. antitrust law, namely the Sherman Act. No U.S. court has held that seeking or enforcing injunctive relief on a FRAND-assured SEP constitutes an antitrust violation. Instead, every U.S. court that has addressed the injunction issue has done so under contract, not antitrust, principles.[30] The DOJ has stated that it is "continu[ing] to explore where there is room for liability under Section 2 of the Sherman Act in cases where holders of F/RAND-encumbered SEPs seek injunctive relief after a standard is in place."[31]

Moreover, the FTC's 2015 Section 5 Policy Statement would arguably preclude it from bringing future actions like *Bosch* and *Motorola*. The Statement sets forth three basic principles to limit and guide future applications of the Commission's standalone unfair methods of competition authority.[32] The primary thrust of these principles is to link the FTC's standalone authority to the rule of reason as applied under the traditional antitrust laws and to not apply Section 5 to conduct if the U.S. antitrust laws (the Sherman Act or the Clayton Act) are sufficient to address the competitive concern at issue.[33] Given U.S. case law on holdup by patent holders, which requires ex ante deception and but-for causation (i.e., but-for the alleged deception, the SDO would not have adopted the technology at issue), the Sherman Act precedent will likely preclude future applications of Section 5 to patent holdup cases under the Statement.[34]

V. Foreign Actions—The Domino Effect

Within days of the DOJ's issuance of its IEEE Business Review Letter, competition enforcers around the world reportedly received English translations of the letter. Some of them subsequently remarked (at numerous international conferences) that the DOJ endorses prohibitions on seeking and obtaining injunctive relief on FRAND-assured SEPs and condemns end-user device licensing in favor of component-level licensing.[35] Similarly, following the FTC's consent agreements in *Bosch* and *Motorola Mobility/Google*, competition agencies around the world, including in Canada, China, Korea, and Japan, adopted similar approaches, namely by creating competition law sanctions for seeking or enforcing injunctive relief on FRAND-assured SEPs against willing licensees.

For example, in December of 2014 and again in 2016, the Korea Fair Trade Commission revised its Guidelines on the Unfair Exercise of Intellectual Property Rights, adding provisions addressing conduct involving SEPs, including provisions on injunctive relief.[36] Similarly, in 2016, Canada's Bureau of Competition revised its Intellectual Property Enforcement Guidelines, adding provisions on injunctive relief, among others.[37] Also in 2016, the Japan Fair Trade Commission revised its Guidelines for the Use of Intellectual Property Under the Antimonopoly Act, adding provisions on when a patent holders' seeking or enforcing injunctive relief on a FRAND-assured SEP may constitute an antitrust or unfair trade practices violation.[38] In Spring 2014, China's State Administration for Industry and Commerce issued rules governing antitrust enforcement of IPRs. Since then, China's three Anti-Monopoly Law (AML) agencies (along with China's patent office) have issued various competing draft guidelines on the exercise of IPRs, which contain numerous provisions governing conduct involving SEPs.[39] China's State Council is reportedly considering the various competing drafts and will ultimately issue one set of guidelines to govern

30 *See, e.g.,* Realtek Semiconductor Corp. v. LSI Corp., 2013 WL 2181717, at *7 (N.D. Cal. May 20, 2013); Verdict Form at 3, Microsoft v. Motorola, Case No. C10-1823JLR (W.D. Wash. Sept. 4, 2013) (the jury found that Motorola's conduct in seeking injunctive relief violated its duty of good faith and fair dealing with respect to its contractual commitments to the IEEE and the ITU); Apple v. Motorola, Inc., 869 F. Supp. 2d 901, 913–14 (N.D. Ill. 2012); Microsoft Corp. v. Motorola, Inc., 696 F.3d 872, 884–85 (9th Cir. 2012).

31 Renata Hesse, Deputy Assistant Attorney Gen., U.S. Dep't of Justice, The Art of Persuasion: Competition Advocacy at the Intersection of Antitrust and Intellectual Property 9 (Nov. 8, 2013), http://www.justice.gov/atr/public/speeches/301596.pdf.

32 Fed. Trade Comm'n, Statement of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act (Aug. 13, 2015), https://www.ftc.gov/system/files/documents/public_statements/735201/150813section5enforcement.pdf.

33 *See* Fed. Trade Comm'n, Statement of the Federal Trade Commission on the Issuance of Enforcement Principles Regarding "Unfair Methods of Competition" Under Section 5 of the FTC Act 1 (Aug. 13, 2015), https://www.ftc.gov/system/files/documents/public_statements/735381/150813commissionstatementsection5.pdf ("Our statement makes clear that the Commission will rely on the accumulated knowledge and experience embedded within the 'rule of reason' framework developed under the antitrust laws over the past 125 years—a framework well understood by courts, competition agencies, the business community, and practitioners.").

34 Joshua D. Wright & Angela M. Diveley, *Unfair Methods of Competition After the 2015 Commission Statement*, Antitrust Source, Oct. 2015, at 1, 11 n.60.

35 The authors have firsthand knowledge of these remarks.

36 Korea Fair Trade Comm'n, Review Guidelines on Unfair Exercise of Intellectual Property Rights (2014), http://eng.ftc.go.kr/bbs.do?command=getList&type_cd=62&pageId=0401; Press Release, *KFTC Rationalizes Its Regulations on SEPs to Promote Technology Innovation* (Mar. 30, 2016), http://eng.ftc.go.kr/bbs.do (amending 2014 KFTC IP Guidelines).

37 Competition Bureau Canada, Enforcement Guidelines: Intellectual Property (2016), http://www.competitionbureau.gc.ca/eic/site/cb-bc.nsf/vwapj/cb-IPEG-e.pdf/$file/cb-IPEG-e.pdf.

38 Japan Fair Trade Comm'n, Guidelines for the Use of Intellectual Property Under the Antimonopoly Act (2016), http://www.jftc.go.jp/en/legislation_gls/imonopoly_guidelines.files/IPGL_Frand.pdf.

39 State Admin. for Indus. & Commerce, Rules of the Admin. for Indus. and Commerce on the Prohibition of Intellectual Property Rights for the Purposes of Eliminating or Restricting Competition (2015).

all three AML agencies. In February 2015, China's National Development and Reform Commission imposed a $975 million fine against Qualcomm based, in large part, on allegations that the company charged "excessive" royalties on SEPs by charging for expired patents, requiring royalty-free grantbacks, bundling SEPs and non-SEPs, and basing its royalties on the wholesale net selling price of end-user devices as opposed to a percentage of the selling price or a smaller component part.[40] The investigation also involved allegations that Qualcomm violated China's AML by bundling sales of patents and chips and refusing to license patents to chip manufacturers.[41] In 2013 and 2014, the Competition Commission of India issued investigation orders against Ericsson alleging that the company violated its FRAND assurances by imposing discriminatory and "excessive" royalty rates by basing royalties on the end-user device as opposed to a component part, such as a chipset, and by using Non-Disclosure Agreements.[42]

VI. Empirical Evidence on Holdup by Patent Holders

Holdup requires lock-in, and standard-implementing companies with asset-specific investments can be locked in to the technologies defining the standard. On the other hand, innovators that are contributing to SDOs can also be locked-in, and hence susceptible to holdup, if their technologies have a market only within the standard. Thus, incentives to engage in holdup run in both directions.[43] There is also the possibility of holdout by an implementer. While holdup by implementers refers to the situation in which a licensee uses its leverage to obtain rates and terms below FRAND levels, holdout refers to a licensee either refusing to take a FRAND license or delaying its doing so.[44]

While there is serious and important scholarly work exploring the theoretical conditions under which holdup by patent holders might occur, this literature merely demonstrates the possibility that an injunction (or the threat of an injunction) against infringement of a patent can in certain circumstances be profitable for the licensor and potentially harmful to consumers.[45] This same theoretical literature has also recognized, with respect to both intellectual and tangible property, the threat of both holdup and holdout by implementers. Theories of anticompetitive harm predict systematic opportunism by patent holders and price increases across output markets that depend upon patented technology as an input. These theories predict, in addition to higher final product prices, reduced output and less innovation.[46]

Creating a competition law sanction for seeking or enforcing injunctive relief requires, as a matter of sound economic policy, that there be a probability, not a mere possibility, of higher prices, reduced output, and lower rates of innovation if such relief is pursued. The claim that existing sanctions within antitrust law, contract law, and patent doctrine do not adequately deter patent holdup, and thus expose consumers to the anticompetitive acquisition and exercise of market power, is a testable one. Thus far, proponents of the claim that current law inadequately deters anticompetitive behavior in standard setting have not satisfied the burden they bear to substantiate a change in policy. Indeed, the available evidence not only does not support the claim that holdup is widespread, it appears to suggest SEP-heavy industries are highly competitive, and characterized by robust innovation as well as falling prices and increased output when compared to industries that do not rely upon SEPs.[47]

For example, evidence from the smartphone market, which is both standard and patent intensive, is to the contrary: Output has grown exponentially, while market concentration has fallen, and wireless service prices have dropped relative to the overall consumer price index (CPI).[48] More generally, prices in

40 Koren W. Wong-Ervin, *Antitrust and IP in China: Quo Vadis?*, Spring Meeting CLE (ABA Section of Antitrust Law) 5–6 (Apr. 16, 2015), https://www.ftc.gov/system/files/attachments/key-speeches-presentations/wong-ervin_-_2015_aba_spring_meeting_4-16-15.pdf [hereinafter Wong-Ervin, *Quo Vadis?*]. *See also* Press Release, *Qualcomm, Inc., Qualcomm and China's National Development and Reform Commission Reach Resolution* (Feb. 9, 2015), http://files.shareholder.com/downloads/QCOM/3864235320x0x808060/382E59E5-B9AA-4D59-ABFF-BDFB9AB8F1E9/Qualcomm_and_China_NDRC_Resolution_final.pdf.

41 Wong-Ervin, *Quo Vadis?*, *supra* note 40, at 6.

42 *See* CCI Order under Section 26(1) of the Competition Act, 2002, In re: Micromax Informatics Ltd. v. Telefonaktiebolaget LM Ericsson ¶ 17 (Nov. 12, 2013), http://cci.gov.in/May2011/OrderOfCommission/261/502013.pdf; CCI Order under Section 26(1) of the Competition Act, 2002, In re Intex Techn. Ltd., v. Telfonaktiebolaget LM Ericsson ¶ 17 (Jan. 16, 2014), http://cci.gov.in/May2011/OrderOfCommission/261/762013.pdf. The first investigation was brought based on complaints from Micromax Informatics Ltd.; the second was brought based on complaints from Intex Technologies (India) Ltd. *See also* Koren W. Wong-Ervin, *Standard Essential Patents: The International Landscape*, Public Domain (ABA Section of Antirust Law) (Spring 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2668602.

43 *Id.*

44 *Id.*

45 Douglas H. Ginsburg et al., *The Troubling Use of Antitrust to Regulate FRAND Licensing,* 10 Competition Policy International Antitrust Chronicle, no. 1, 2015, at 2, 4, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2674759 [hereinafter Ginsburg et al., *The Troubling Use*].

46 *Id.*

47 *See, e.g.*, J. Gregory Sidak, *The Antitrust Division's Devaluation of Standard-Essential Patents*, 104 Geo. L.J. Online 48, 61 (2015) (collecting studies at n.49) ("By early 2015, more than two dozen economists and lawyers had disapproved or disputed the numerous assumptions and predictions of the patent-holdup and royalty-stacking conjectures."), https://www.criterioneconomics.com/docs/antitrust-divisions-devaluation-of-standard-essential-patents.pdf; Anne Layne-Farrar, Patent Holdup and Royalty Stacking Theory and Evidence: Where Do We Stand After 15 Years of History? (2014) (surveying the economic literature and concluding that the empirical studies conducted thus far have not shown holdup is a common problem), http://www.oecd.org/officialdocuments/publicdisplaydocumentpdf/?cote=DAF/COMP/WD%282014%2984&doclanguage=en.

48 According to data from Gartner, worldwide smartphone sales to end-users have increased over 900 percent from 2007 to 2014, and 320 percent from 2010 to 2014. Market concentration in smartphones, as measured by HHIs, went from "highly concentrated" in 2007, as defined by the U.S. Antitrust Agencies' Horizontal Merger Guidelines, to "unconcentrated" by the end of 2012. *See* Keith Mallinson, *Theories of Harm with SEP Licensing Do Not Stack Up*, IP Fin. Blog (May 24, 2013), http://ipfinance.blogspot.com/2013/05/theories-of-harm-with-sep-licensing-do.html. According to the U.S. Bureau of Labor Statistics, the ratio of the CPI for wireless

SEP-reliant industries in the United States have declined faster than prices in non-SEP intensive industries.[49] A recent study by the Boston Consulting Group found that, globally, the cost per megabyte of data declined 99 percent from 2005 to 2013 (reflecting both innovations making data transmission cheaper and the healthy state of competition); the cost per megabyte fell 95 percent in the transition from 2G to 3G, and 67 percent in the transition from 3G to 4G; and the global average selling price for smartphones decreased 23 percent from 2007 through 2014, while prices for the lowest-end phones fell 63 percent over the same period.[50] All of this indicates a thriving mobile market, not a market in need of fixing, and suggests caution prior to disrupting the carefully balanced FRAND ecosystem.

As evidence of holdup, some point to a small number of litigated cases in which the court-determined FRAND royalty was lower than the patent holder's original demand. Among the numerous flaws with this argument—even setting aside the reasonable debate over whether the courts correctly determined reasonable royalty damages in those cases—is that the outcome of a handful of litigated cases says nothing about whether holdup is a widespread problem for competition and consumers.[51] Economists have long understood the shortcomings of making inferences about a population from a sample of litigated cases.[52]

Economic analysis provides the basis upon which to understand the apparent disconnect between holdup theory and the available evidence. As economic theory would predict, patent holders and those seeking to license and implement patented technologies write their contracts so as to minimize the probability of holdup. Indeed, the original economic literature upon which the patent holdup theories are based was focused upon the various ways that market actors use reputation, contracts, and other institutions to mitigate the inefficiencies associated with opportunism in transactions involving tangible property.[53]

Several market mechanisms are available to transactors to mitigate the incidence and likelihood of patent holdup. Reputational and business costs may deter repeat players from engaging in holdup and "patent holders that have broad cross-licensing agreements with the SEP-owner may be protected from hold-up."[54] Also, patent holders often enjoy a first-mover advantage if their technology is adopted as the standard. "As a result, patent holders who manufacture products using the standardized technology 'may find it more profitable to offer attractive licensing terms in order to promote the adoption of the product using the standard, increasing demand for its product rather than extracting high royalties'" per unit.[55] This result is not surprising given the incentives of patent holders and implementers to reach efficient solutions that minimize the risk of opportunism.

Recently, some have asserted that the theoretical predictions of holdup models cannot be tested and thus it is only prudent to assume a systemic holdup problem. This is incorrect as a matter of economics. It is also inconsistent with economic methodology and the scientific method more generally. Were ex post opportunism in licensing SEPs a systematic problem—that is, were market failure preventing firms from efficiently contracting to minimize their risk—one would expect to observe one-sided SDO contracts that do not reflect the risk of opportunism and that primarily protect SEP holders rather than potential licensees. However, the empirical evidence shows that SDO contract terms vary both across organizations and over time in response to changes in the perceived risk of patent holdup and other factors.[56]

Recognizing the speculative nature of holdup concerns, the Federal Circuit (which has nationwide jurisdiction over patent disputes) has held that a claim of holdup must be substantiated

telephone services to the overall CPI has dropped 34% from 2007 to 2014.

49 Alexander Galetovic et al., *An Empirical Examination of Patent Hold-Up* (Nat'l Bureau of Econ. Research, Working Paper No. 21090, Apr. 2015), http://www.nber.org/papers/w21090.pdf.

50 Julio Bezerra et al., The Mobile Revolution: How Mobile Technologies Drive a Trillion Dollar Impact 3, 9 (The Boston Consulting Grp., Jan. 15, 2015), https://www.bcgperspectives.com/content/articles/telecommunications_technology_business_transformation_mobile_revolution/#chapter1.

51 It is worth noting that the district courts in the cases relied upon by commentators (e.g., *Microsoft v. Motorola* and *Innovatio*) employed methodologies that presumed the prevalence of both holdup and royalty stacking without requiring proof that either exists in a particular case. *See* Microsoft Corp. v. Motorola, Inc., 2013 WL 2111217, at *12, *73–74 (W.D. Wash. Apr. 25, 2013); In re Innovatio IP Ventures, LLC Patent Litig., 2013 WL 5593609, at *8-10 (N.D. Ill. Oct. 3, 2013). This approach was squarely rejected by the Federal Circuit Court of Appeals in *Ericsson v. D-Link Systems*, which held that to be considered as part of a FRAND damages analysis, concerns about holdup and royalty stacking must be proven rather than presumed. 773 F.3d 1201, 1234 (Fed. Cir. 2014). *See also* Sidak, *supra* note 47, at 65 (explaining that the adjudicated rates in *Microsoft v. Motorola* and *Innovatio* were not necessarily high enough to be FRAND, and that "[t]he methodologies used to determine the final rates in those two decisions contained significant economic flaws"); Layne-Farrar & Wong- Ervin, *supra* note 23, at 5–6.

52 *See, e.g.,* George L. Priest & Benjamin Klein, *The Selection of Disputes for Litigation*, 13 J. Legal Studies 1 (1984).

53 Benjamin Klein, *Why Hold-Ups Occur: The Self-Enforcing Range of Contractual Relationships*, 34 Econ. Inquiry 444, 449–50 (1996); Benjamin Klein et al., *Vertical Integration, Appropriate Rents, and Competitive Contracting Process*, 21 J.L. & Econ. 297, 303–07 (1978); Oliver E. Williamson, Markets and Hierarchies: Analysis and Antitrust Implications 26–30 (New York: Free Press 1975); *see also* Joshua D. Wright, Comm'r, Fed. Trade Comm'n, Remarks Before George Mason University School of Law: SSOs, FRAND, and Antitrust: Lessons Learned from the Economics of Incomplete Contracts 2–3 (Sept. 12, 2013), https://www.ftc.gov/sites/default/files/documents/public_statements/ssos-frand-and-antitrust-lessons-economics-incomplete-contracts/130912cpip.pdf ("[T]he economics of hold-up began not as an effort to explain contract failure, but as an effort to explain real world contract terms, performance, and the enforcement decisions starting with the fundamental premise that contracts are necessarily incomplete.").

54 *See, e.g.*, Suzanne Munck, Fed. Trade Comm'n, Prepared Statement of the Federal Trade Commission Before the U.S. Senate Committee on the Judiciary Subcommittee on Antitrust, Competition Policy and Consumer Rights Concerning "Standard Essential Patent Disputes and Antitrust Law" 6 (July 30, 2013), https://www.ftc.gov/sites/default/files/documents/public_statements/prepared-statement-federal-trade-commission-concerning-standard-essential-patent-disputes-and/130730standardessentialpatents.pdf.

55 *Id.* (internal citation omitted).

56 *See* Tsai & Wright, *supra* note 2.

with "actual evidence," and that the burden is on the accused infringer to show that the patent holder used injunctive relief to gain undue leverage and demand supra-FRAND royalties.[57]

VII. Policy Recommendations

Antitrust agencies should refrain from issuing or otherwise making policy recommendations on SDO IPR Policies. The issues and choices regarding specific rules are best left to individual SDOs and their members to decide. The issuance of recommendations by a government agency may unduly influence private SDOs and their members to adopt policies that might not otherwise gain consensus support within a particular SDO and that may not best meet the needs of that SDO, its members, and the public. This could occur because the SDO believes failing to adopt the specified policy is not permitted or because failing to adopt the policy could subject the SDO and its members to other legal liabilities.

SDOs should ensure that their voting procedures are fair, transparent, and consensus-based. Consensus-based voting procedures, which ensure that standardized technologies are selected on the basis of technological merit by technical experts, are critical. For more than three decades, the SDOs for core wireless technologies have functioned as a true technological meritocracy. This dynamic has allowed disruptive technologies to achieve a fair hearing, even over the objections of very large incumbents, and the market to choose the ultimate winner between competing approaches to next generation standards. Likewise, it is critical that the development of any revisions to SDO IPR Policies be conducted in a fair, transparent, and consensus-based manner that reflects the views of a particular SDO's members.

For the reasons set forth below, agencies should not impose an antitrust law sanction for seeking or enforcing injunctive relief, which would likely reduce incentives to innovate and deter SEP holders from participating in standard setting, thereby depriving consumers of the substantial procompetitive benefits of standardized technologies.[58] An antitrust sanction is not only unnecessary to protect consumer welfare given that the law of contracts is sufficient to provide optimal deterrence, but is likely to be harmful.[59]

First, significant monetary sanctions are likely to over-deter procompetitive participation in SDOs; FRAND-assured SEP holders need the credible threat of an injunction if they are to recoup the value added by their patents and have no other adequate remedy against an infringing user. Indeed, excessive deterrence is particularly likely because, with liability turning upon whether the infringing user was truly a "willing licensee"—a factual determination that may be far from clear in many cases—the outcome of an antitrust case will necessarily be uncertain. The prospect of penalizing a FRAND-assured SEP holder for seeking injunctive relief diminishes the value of its patents and hence reduces its incentive to innovate.

Second, the prospect of antitrust liability for a patentee seeking injunctive relief would enable an infringing user to negotiate in bad faith, knowing its exposure is capped at the FRAND royalty rate; in this way, an unscrupulous or a judgment-proof infringing user can force the SEP holder to take a below-FRAND rate. Indeed, when the worst penalty an SEP infringer faces is not an injunction but merely paying, after a neutral adjudication, the FRAND royalty that it should have agreed to pay when first asked, then reverse holdup and holdout give implementers a profitable way to defer payment—or, if they are judgment proof, to avoid payment altogether—and puts SEP holders at a disadvantage that reduces the rewards from, and can only discourage innovation and participation in, standard setting.[60]

Third, antitrust liability is likely to deter patent holders from contributing their technology to an SDO under FRAND terms if doing so will require them to forfeit their right to protect their intellectual property by seeking an injunction against infringing users. These possibilities, far from protecting the public interest in competition and innovation, actually threaten to reduce the gains from innovation and standardization.[61]

Finally, if competition agencies decide to adopt such a sanction, at the very least they should adopt an approach similar to that crafted by the European Court of Justice in *Huawei v. ZTE*, in which the court adopted a safe harbor from antitrust liability.[62] Under this safe harbor, an SEP holder is free from liability if: (1) prior to initiating an infringement action, it alerts the alleged infringer to the claimed infringement and specifies the way in which the patent has been infringed; and (2) after the alleged infringer has expressed its willingness to conclude a license agreement on FRAND terms, presents to the alleged infringer a specific, written offer for a license, specifying the royalty and calculation methodology. The Court put the burden on the alleged infringer to "diligently respond" to the SEP holder's offer, "in accordance with recognized commercial practices in the field and in good faith," by promptly providing a specific written counter-offer that corresponds to FRAND terms, and by providing appropriate security (e.g., a bond or

57 *See, e.g.*, *Ericsson, Inc.*, 773 F.3d at 1234 ("In deciding whether to instruct the jury on patent hold-up and royalty stacking, again, we emphasize that the district court must consider the evidence on the record before it. The district court need not instruct the jury on hold-up or stacking unless the accused infringer presents actual evidence of hold-up or stacking. Certainly something more than a general argument that these phenomena are possibilities is necessary."). *See also* Layne-Farrar & Wong-Ervin, *supra* note 23, at 5–7.

58 *See* Douglas H. Ginsburg et al., *Enjoining Injunctions: The Case Against Antitrust Liability for Standard Essential Patent Holders Who Seek Injunctions*, Antitrust Source, Oct. 2014, at 1, 5–6 (explaining, among other things, that the law of contracts is sufficient to provide optimal deterrence). *See also* Bruce H. Kobayashi & Joshua D. Wright, *The Limits of Antitrust and Patent Holdup: A Reply to Cary, et al.*, 78 Antitrust L.J. 505 (2012).

59 Ginsburg et al., *The Troubling Use*, *supra* note 45, at 7.

60 *Id.*

61 *Id.*

62 Case C-170/13, *Huawei Techs. Co. v. ZTE Corp.*, ECLI:EU:C:2015:477 (ECJ July 16, 2015), http://curia.europa.eu/juris/document/document.jsf?text=&docid=165911&pageIndex=0&doclang=EN&mode=lst&dir=&occ=first&part=1&cid=603775.

funds in escrow) from the time at which the counter-offer is rejected and prior to using the teachings of the SEP.[63]

In its decision, the Court recognized that SEP holders have "the right to bring an action for prohibitory injunction or for the recall of products," and made clear that the SEP holder's right can be limited only in particular and exceptional circumstances.[64] The decision recognizes concerns about holdup by both patent holders and implementers, stating that the Court will not tolerate infringers' "delaying tactics."[65]

VIII. Conclusion

In the past several years, the U.S. antitrust agencies have taken a number of positions with respect to SEPs that are unsupported by (and at times contrary to) the available economic evidence. These decisions devalue IPRs and seem to urge intervention in favor of one side or another in private licensing disputes. In the 1970s, the agencies infamously announced the "Nine No-Nos," a set of practices a patent holder could not engage in without running afoul of the antitrust laws. By the 1990s, the U.S. agencies took the lead in renouncing those anti-innovation policies in favor of a more analytical approach that would reject special antitrust rules and presumptions against intellectual property. If the United States is to remain the global leader in antitrust policy that protects consumers and innovation, it must lead by example once again in the area of patent licensing by taking an objective look at the data driving their own patent policy positions, and considering the influence those positions have on critical and emerging antitrust authorities.

63 *Id.* ¶¶ 66–67.

64 *Id.* ¶¶ 65–66, 71.

65 *Id.* ¶ 65.

Full Board Decisions of the National Labor Relations Board: Fiscal Year 2016

By John N. Raudabaugh

Note from the Editor:

This article critically reflects on the most recent term of the National Labor Relations Board. The author describes and critiques the eleven full Board decisions made in Fiscal Year 2016.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. Whenever we publish an article that advocates for a particular position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article. We also invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

• Timothy Noah and Brian Mahoney, *Obama labor board flexes its muscles*, Politico (Sept. 1, 2015), http://www.politico.com/story/2015/09/unions-barack-obama-labor-board-victories-213204.

• Tim Devaney, *Enraging industry, labor board asserts its power under Obama*, The Hill (Aug. 29, 2015), http://thehill.com/regulation/labor/252232-enraging-industry-labor-board-asserts-its-power-under-obama.

• Michael Hiltzik, *Labor regulators strike another blow against employers shortchanging workers*, L.A. Times (July 13, 2016), http://www.latimes.com/business/hiltzik/la-fi-hiltzik-nlrb-jpoint-employer-20160713-snap-story.html.

• IBEW Media Center, *Yes, the Bureaucracy Matters to You. Here's Why.* (June 17, 2016), http://www.ibew.org/media-center/Articles/16Daily/1606/160617_NLRB_appointments_matter.

• Mark Joseph Stern, *In Landmark Decision, NLRB Allows Graduate Students at Private Universities to Unionize*, Slate (Aug. 23, 2016), http://www.slate.com/blogs/the_slatest/2016/08/23/nlrb_lets_graduate_students_at_private_universities_unionize.html.

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National Labor Relations Board ("NLRB" or "Board") Chairman Pearce describes the Board as having "just recently stepped 'out of the attic and into the kitchen' to help the modern laborer."[1] A review of Fiscal Year 2016 full Board decisions suggests that Pearce views the Board's role as kitchen chef controlling, not only the menu, but the portions served to the parties.

The National Labor Relations Act ("Act" or "NLRA"),[2] as amended, authorizes a Board with five members appointed by the President by and with the advice and consent of the U.S. Senate.[3] The NLRB began Fiscal Year 2016 (October 1, 2015 through September 30, 2016) with four members following the August 27, 2015 expiration of Republican member Johnson's term. The Board was reduced to three members on August 27, 2016 with the expiration of Democrat member Hirozawa's term. The Board issued 298 published decisions in FY 2016, including 11 "full" Board decisions.[4] Full Board decisions are decisions in which all current members of a Board with three or more members participate, and which can overturn or change precedents.[5] There were 138 dissenting opinions; the lone Republican member dissented in 134 decisions, including all of the 11 full Board decisions reviewed below in chronological order.

On December 22, 2015, in *SolarCity Corp.*, a Board majority consisting of Chairman Pearce and Members Hirozawa and McFerran held that the employer unlawfully maintained a mandatory arbitration agreement requiring employees, as a condition of employment, to waive their rights to file class or collective actions in all forums, whether arbitral or judicial.[6] The majority reasoned that the fact that employees could file administrative charges with government agencies which could seek class or group remedies was insufficient to guarantee employees' rights to engage in concerted legal activity. The

1 Mollie Cramer, *NLRB Chair: Board Gives Employee Voice in Workplace*, The Cornell Daily Sun (October 25, 2016), http://cornellsun.com/2016/10/25/nlrb-chair-board-gives-employee-voice-in-workplace/.

2 29 U.S.C. §§151 et seq.

3 29 U.S.C. §153(a).

4 *NLRB Watch: The Raudabaugh Report: Tracking NLRB Member Voting Patterns*, National Right to Work Legal Defense Foundation, http://www.nrtw.org/en/nlrb-watch/raudabaugh-report-tracking-nlrb-member-decisions. The Report is updated continuously noting issued decisions and dissents by member, panel, and initiating regional office.

5 Letter from Wilma B. Liebman, Chairman of the NLRB, to Hon. Phil Roe, Chairman of the subcommittee on Health, Education, Labor, and Pensions, Committee on Education and the Workforce, U.S. House of Representatives (Feb. 25, 2011), https://www.nlrb.gov/sites/default/files/attachments/basic-page/node-3302/chairmancommitteeletter.pdf (detailing Board tradition with respect to acting with fewer than five members).

6 363 NLRB No. 83 (December 22, 2015), petition for writ of certiorari filed, No. 16-307 (September 9, 2016).

majority noted that there is a wide range of employment-related claims not within the purview of any administrative agency, that agencies may exercise discretion to not pursue employees' claims, and that access to a typical administrative agency is not access to a "judicial forum" as is required to satisfy the Board's decisions in *D.R. Horton*[7] and *Murphy Oil*.[8] Dissenting Member Miscimarra would have found such agreements lawful because the NLRA does not create a substantive right to insist on class treatment of non-Act claims, a class waiver for non-Act claims does not infringe on statutory rights or obligations, and enforcement of non-Act class waivers is warranted by the Federal Arbitration Act.[9]

In *Guardsmark, LLC*, the Board majority overruled 57 years of precedent by holding unlawful a "captive audience" meeting in which an employer attempted to persuade employees against supporting a union during the 24 hour period before ballots were scheduled to be mailed to eligible employee voters.[10] *Oregon Washington Telephone*—the 1959 precedent overruled in *Guardsmark*—prohibited mass campaign meetings only once the ballots were scheduled to be mailed.[11] The *Guardsmark* majority reasoned that the new rule would reduce confusion when compared with its *Peerless Plywood Co*.[12] decision prohibiting such gatherings within the 24 hour period prior to the start of an in-person election. In dissent, Member Miscimarra objected to the majority now prohibiting "captive audience" meetings for a longer period.

On June 9, 2016, the Board overruled a 32-year-old precedent to find that an employer that had voluntarily recognized a "mixed-guard" union of both guard and non-guard employees could not withdraw recognition upon contract expiration without showing a loss of majority support.[13] At issue in *Loomis Armored US, Inc.* was Section 9(b)(3) of the Act, which prohibits the Board from deciding that any unit is appropriate for the purposes of collective bargaining "if it includes, together with other employees, any individual employed as a guard to enforce against employees and other persons rules to protect property of the employer or to protect the safety of persons on the employer's premises."[14] The Board majority reasoned that despite the statutory language, requiring an employer to demonstrate loss of majority support promotes the statutory goals of promoting stable labor relations.

In *Graymont PA, Inc.*,[15] the Board rejected the employer's defense of its unilateral changes to work rules, absentee policy, and progressive discipline schedule under the "contract coverage" standard applied by the D.C. Circuit and seven other circuit courts of appeal. The Board insisted that any contract waiver must be "clear and unmistakable." Notably, the Board's adamancy on contract waiver language was soundly rebuked three months later in *Heartland Plymouth Court MI, LLC v. NLRB*.[16] The D.C. Circuit majority found that the Board majority took "obduracy to a new level" when it again ignored the court's rebuke for insisting on "clear and unmistakable" contract language in a management-rights clause to waive a union's right to bargain over a specific matter during the term of a collective agreement.[17] The Board was ordered to pay the employer nearly $18,000 in legal fees incurred due to the Board's asserted policy of "nonacquiescence."

In *Miller & Anderson, Inc.*,[18] the Board majority overturned *Oakwood Care Center*[19] and returned to the rule in *M.B. Sturgis, Inc.*,[20] which had previously overruled *Lee Hospital*.[21] The Board held employer consent unnecessary for bargaining units including both jointly employed and solely employed employees of a single "user" employer. In dissent, Member Miscimarra reasoned that the majority's decision in this case, which extended the joint-employer standard the majority had adopted in *Browning-Ferris*,[22] creates an unworkable situation with a unit in which parties have widely divergent interests and a majority of employees have no employment relationship with the "supplier" employer.

A charter school was found subject to Board jurisdiction for the first time in *Pennsylvania Virtual Charter School*.[23] Relying on Section 2(2) of the Act and the Supreme Court's decision in *NLRB v. National Gas Utility District of Hawkins*

7 357 NLRB No. 184, enf. denied in relevant part 737 F.3d 344 (5th Cir. 2014).

8 361 NLRB No. 72 (2014), enf. denied in relevant part 808 F.3d 1023 (5th Cir. 2015). Many scholars adamantly support the Board majority's view. *See* Christine Neylon O'Brien, *Will the Supreme Court Agree with the NLRB That Pre-Dispute Employment Arbitration Provisions Containing Class and Collective Action Waivers in Both Judicial and Arbitral Forums Violate the National Labor Relations Act - Whether There is an Opt-Out or Not?*, 19 U. Pa. J. Bus. L. ___ (2017).

9 9 U.S.C. §§1 et. seq.

10 363 NLRB No. 103 (2016). *See* Shaun Richman, *Could a New NLRB Case Limit Bosses' Best Anti-Union Tool, the Captive Audience Meeting?*, In These Times (Feb. 3, 2016).

11 123 NLRB 339 (1959).

12 107 NLRB 427 (1953).

13 Loomis Armored US, Inc., 364 NLRB No. 23 (June 9, 2016), overruling Wells Fargo Corp., 270 NLRB 787 (1984), rev. denied sub nom. Truck Drivers Local Union No. 807 v. NLRB, 755 F.2d 5 (2d Cir. 1985).

14 29 U.S.C. §§159(b)(3).

15 364 NLRB No. 37 (June 29, 2016). The long running debate regarding contract construction was reviewed in Matthew D. Lahey, *I Thought We Had a Deal?!: The NLRB, the Courts, and the Continuing Debate over Contract Coverage vs. Clear and Unmistakable Waiver*, 25 ABA J. Lab. & Emp. L. 37 (2009).

16 No. 15-1034, 2016 WL 5485145 (D.C. Cir., Sept. 30, 2016).

17 *Id.*

18 364 NLRB No. 39 (July 11, 2016).

19 343 NLRB 659 (2004).

20 331 NLRB 1298 (2000).

21 300 NLRB 947 (1990).

22 362 NLRB No. 186 (2015) (3-2 decision).

23 364 NLRB No. 87 (Aug. 24, 2016). *See* Martin H. Malin and Charles Taylor Kerchner, *Charter Schools and Collective Bargaining: Compatible Marriage or Illegitimate Relationship?*, 30 Harv. J.L. & Pub. Pol'y 885 (2007).

County,[24] the Board majority found that the school was neither created directly by the state nor a political subdivision with school administrators responsible to public officials or the general electorate. In dissent, Member Miscimarra would have declined jurisdiction because of the school's insubstantial effect on interstate commerce and in order to foster certainty and predictability.

In the much anticipated *Columbia University* decision, the Board held that student teaching and research assistants are statutory employees under Section 2(3) of the Act[25] if their relationship with the university satisfies the common law "right to control" test for employment.[26] This decision overruled *Brown University*,[27] which had previously overruled *New York University*.[28] Dissenting Member Miscimarra viewed collective bargaining and the resort to economic weapons as likely to upset the educational process quite apart from any economic interests of participating student assistants.

The Board overhauled its make-whole remedy in *King Soopers, Inc*.[29] The majority reasoned that search-for-work and interim employment expenses had been wrongly treated as offsets to interim earnings rather than as an additional element of backpay:

> Fully compensating discriminatees for search-for-work and interim employment expenses even when a discriminatee's interim earnings equal or exceed his or her lost earnings and expenses appropriately relates to the policies of the Act because this approach will deter unfair labor practices and encourage robust job search efforts.[30]

In dissent, Member Miscimarra argued that this new remedial formula will result in greater than make-whole relief in some cases and protracted litigation.

In *Total Security Management Illinois 1, LLC*,[31] the Board reaffirmed the reasoning of *Alan Ritchey, Inc*.[32] The majority held that an employer must provide the union notice and an opportunity to bargain before imposing discretionary discipline on employees represented by a union that has not yet entered into a collective bargaining agreement with the employer. Dissenting Member Miscimarra argued that the majority's decision upends "decision and effects bargaining" principles, requires bargaining over actions that are consistent with the manner in which the employer applied discipline in the past, imposes disfavored single-issue bargaining, and ignores longstanding precedent regarding waiver of collective-bargaining rights.

In *E.I. Du Pont de Nemours*, the Board held unlawful any discretionary unilateral changes to union-represented employees' benefit plans made pursuant to past practice under a management-rights clause in an expired collective bargaining agreement while the parties were negotiating a successor agreement and had not reached impasse.[33] The case was decided on remand from the D.C. Circuit.[34] In reaching its decision, the Board majority overruled *Beverly Health & Rehabilitation Services* (2006),[35] *Courier-Journal*,[36] and *Capitol Ford*,[37] which had found past practice controlling. The majority instead followed the holdings of *Beverly Health & Rehabilitation Services* (2001)[38] and *Register-Guard*[39] concluding that unilateral, post-contract expiration discretionary changes are unlawful, notwithstanding an expired management-rights clause or past practice pursuant to that clause. The Board majority specifically rejected any rationale that "past practice" involving union acquiescence waives a union's right to bargain over employer post-contract expiration changes which the union opposes. In a lengthy dissent, Member Miscimarra argued that the majority contorted the definition of "change" in the Supreme Court's decision in *NLRB v. Katz*,[40] by considering *anything* done following impasse to be a change requiring notice and an opportunity to bargain, effectively eliminating any consideration of past practices.

The Board adopted a new standard for an administrative law judge's approval of settlement terms a Respondent proposes over the objection of the NLRB General Counsel or the charging party in *Postal Service*.[41] Overturning 29 years of precedent set in *Independent Stave Co*.,[42] Chairman Pearce and Members Hirozawa and McFerran agreed that a consent order accepting and incorporating a Respondent's settlement offer, without agreement of both the General Counsel and the charging party, must provide a "full remedy" for all violations alleged in the complaint, not just a "reasonable" resolution of the dispute. Dissenting Member Miscimarra noted that *Independent Stave* was a rare full, five member unanimous decision approving the practice of administrative law judges' early voluntary

24 402 U.S. 600 (1971).

25 29 U.S.C. §152(3).

26 364 NLRB No. 90 (Aug. 23, 2016).

27 342 NLRB 483 (2004).

28 332 NLRB 1205 (2000). The American Association of University Professors filed an amicus brief in support of graduate student organizing. *See* Catherine Fisk, *Why The NLRB Should Allow Graduate Student Bargaining*, OnLabor (March 2, 2016).

29 364 NLRB No. 93 (Aug. 24, 2016), petition for review filed, No. 16-1316 (D.C. Cir. Sept. 9, 2016).

30 364 NLRB No. 93 at 7.

31 364 NLRB No. 106 (Aug. 26, 2016).

32 359 NLRB 369 (2012). *Alan Ritchey, Inc.* was voided as a result of the Supreme Court's *Noel Canning* decision, which held that President Obama had made invalid recess appointments to the Board.

33 364 NLRB No. 113 (Aug. 26, 2016).

34 E.I. du Pont de Nemours & Co. v. NLRB, 682 F.3d 65 (D.C. Cir. 2012).

35 346 NLRB 1319 (2006).

36 342 NLRB 1093 (2004).

37 343 NLRB 1058 (2004).

38 335 NLRB 635 (2001), enfd. in relevant part 317 F.3d 316 (D.C. Cir. 2003).

39 339 NLRB 353 (2003).

40 369 U.S. 736 (1961).

41 364 NLRB No. 116 (2016).

42 287 NLRB 740 (1987).

"reasonable" resolutions of labor disputes. Miscimarra argued that the majority's requirement of a "full remedy" ignores that there is no certainty that the General Counsel and charging parties will prevail in Board litigation.

A Board majority advocating for "outreach and education" is one thing, but dramatically changing case precedent confuses employees and employers, making compliance ever more difficult. The Act's purpose is clear—employees have the right to choose whether to engage in self-organization and bargain collectively or not. While our 1935 federal labor law needs updating, that task is for Congress. Outcome determination predicated on statutory construction should be consistent over time, not radically altered any time the kitchen crew changes shifts.[43]

43 H.K. Porter Co., Inc. v. NLRB, 397 U.S. 99 at 109 (1970). *See* Benjamin I. Sachs, *Employment Law As Labor Law*, 29 Cardozo L. Rev. 2686 (2008) (discussing using employment law as an alternative to NLRA failures).

Religious Exemptions and Third-Party Harms

By Thomas C. Berg

Note from the Editor:

This article discusses the effect that third-party harms should have on religious accommodations or claims for religious exemptions.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. Whenever we publish an article that advocates for a particular position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article. We also invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

• Frederick Mark Gedicks & Rebecca G. Van Tassell, *RFRA Exemptions from the Contraception Mandate: An Unconstitutional Accommodation of Religion*, 49 Harv. C.R.-C.L. L. Rev. 343 (2014), *available at* http://harvardcrcl.org/wp-content/uploads/2011/09/Gedicks-FINAL-website-edits-3-25-2014.pdf.

• Micah Schwartzman et al., Hobby Lobby *and the Establishment Clause, Part III: Reconciling* Amos *and* Cutter, Balkinization (Dec. 9, 2013), http://balkin.blogspot.com/2013/12/hobby-lobby-and-establishment-clause_9.html, archived at http://perma.cc/VWZ6-JEA6.

• Frederick Mark Gedicks & Andrew Koppelman, *Invisible Women: Why an Exemption for Hobby Lobby Would Violate the Establishment Clause*, 67 Vand. L. Rev. En Banc 51, 59-60 (2014), *available at* https://www.vanderbiltlawreview.org/wp-content/uploads/sites/89/2014/03/Gedicks-and-Koppelman_Invisible-Women.pdf.

• Nelson Tebbe et al., *How Much May Religious Accommodations Burden Others?*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2811815 (forthcoming in Elizabeth Sepper et al., Law, Religion, and Health in the United States (Cambridge Univ. Press, forthcoming 2017)).

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Introduction: Religious Freedom and Third-Party Harms

In recent years religious accommodation issues have become increasingly contentious, particularly issues concerning religious organizations and individuals who object to being forced to facilitate contraception, abortion, or same-sex marriages and relationships. Increasingly, opposition to religious-freedom claims focuses on harm, or the "shifting of costs," to third parties. For example, several scholars argued that exempting for-profit employers from the Obama administration's contraception mandate would violate the Establishment Clause because it would harm employees by denying them the valuable statutory benefit of free insurance coverage for contraception.[1] The federal government likewise argued, in somewhat softer form, that an exemption would harm employees and therefore should be refused under the Religious Freedom Restoration Act (RFRA).[2] The Supreme Court avoided this argument in *Burwell v. Hobby Lobby Stores, Inc.*,[3] by finding that employees could receive identical contraception coverage through insurers and third-party administrators without imposing on objecting employers.

As the contraception-mandate litigation shows, arguments asserting third-party harms take two forms. The first appears when a person or group whose religious practice is substantially restricted by a law makes a claim for an exemption under RFRA, a similar state religious-freedom statute, or a protective state constitutional provision.[4] Under all these provisions, the claimant must first show that applying the law would "substantially burden" religious exercise; if it would, then the government must show that applying the law is the "least restrictive means" of serving a "compelling governmental interest," which it may show—at least in some cases—on the basis that the religious exercise causes certain harms to third parties.[5]

The second sort of assertion of third-party harms arises when a religious exemption has been declared by a legislative enactment or a judicial ruling. The exemption's opponents—government officials or private parties—then might argue that it violates the Establishment Clause. Under case law, a court asking whether an

1 *See, e.g.*, Frederick Mark Gedicks & Rebecca G. Van Tassell, *RFRA Exemptions from the Contraception Mandate: An Unconstitutional Accommodation of Religion*, 49 Harv. C.R.-C.L. L. Rev. 343 (2014), *available at* http://harvardcrcl.org/wp-content/uploads/2011/09/Gedicks-FINAL-website-edits-3-25-2014.pdf; Micah Schwartzman et al., Hobby Lobby *and the Establishment Clause, Part III: Reconciling* Amos *and* Cutter, Balkinization (Dec. 9, 2013), *available at* http://balkin.blogspot.com/2013/12/hobby-lobby-and-establishment-clause_9.html, archived at http://perma.cc/VWZ6-JEA6.

2 42 U.S.C. §§ 2000bb-2000bb-4.

3 134 S. Ct. 2751 (2014).

4 For citations, see Douglas Laycock, *Religious Liberty and the Culture Wars*, 2014 U. Ill. L. Rev. 839, 845 n.26 (listing 19 state RFRAs); *id.* at 844 n.22 (listing 12 state constitutional provisions interpreted to require exemptions).

5 42 U.S.C. § 2000bb-1.

accommodation (exemption) of religious exercise amounts to an establishment of religion should consider, among other things, whether the exemption removes a significant burden from religion and takes "adequate account of the burdens on third parties."[6]

Thus the two arguments, free exercise claims for exemptions and Establishment Clause challenges to exemptions, require looking at similar factors. Both involve examining (1) the nature and seriousness of the burden that the law in question would impose on religious exercise, and (2) the nature and seriousness of the effect on others if the claimant is exempted from the law. But identifying these two considerations does not answer the question how they should be compared with each other. How should burdens on religion and those on others be weighed? And how significant must the third-party harms be to overcome religious claims?

The chief assertion of this article is that harms to others should not be conclusive against religious exemptions under either free exercise or nonestablishment principles. Such harms can certainly be a reason to deny exemption, but they are not the end of the inquiry: a number of factors must be considered. In particular, I argue, Establishment Clause limits on religious exemptions should not be strict. An exemption is not unconstitutional merely because it has negative effects on others: the burdens on others must be significantly disproportionate to the burdens that it removes from religion.

Part I of this article makes general observations about the problem of exemptions and third-party harms. Part II then discusses the scope of accommodation under RFRA or similar state provisions. Part III discusses the limits the Establishment Clause may impose on accommodations that affect others.

I. The Analytical Problem of Third-Party Harms

It may seem obvious that religious freedom does not authorize one person to harm or shift costs to another. Eugene Volokh writes that "religious freedom rights are often articulated as a right to do what your religion motivates you to do, simply because of your religious motivation, but *only so long as it doesn't harm the rights of others*."[7] Obviously religious freedom does not protect killing someone in a ritual sacrifice, or defrauding others because the perpetrator perceives a religious duty.

But the problem comes in defining terms like "causing harms" or "shifting costs." In earlier eras of smaller government, legal prohibitions generally focused on a limited set of direct harms to another's body, physical or financial property, or contractual rights. Thus, a number of founding-era figures emphasized that religious freedom gave no one the right to harm others; but the harms they referred to were immediate, concrete, and serious matters like assault and theft. Pierre Bayle defended magistrates' power and duty "to maintain society and punish all those who destroy the foundations, as murderers and robbers do";[8] and Thomas Jefferson spoke of religious freedom for actions that "neither pic[k] my pocket nor brea[k] my leg."[9]

This framework prohibited many harms, but it also left a large zone of freedom in which religious organizations and individuals could act, in ways that affected others but were not defined as a legal harms. For example, before the rise of modern employment regulation—nondiscrimination laws, collective bargaining requirements, and so forth—religious organizations were legally free to set religiously grounded standards for their employees.

This has changed with the rise of the welfare-regulatory state, which declares much broader legal harms. For example, at-will employment has given way to extensive regulation of the employment relationship: government declares it a legal harm when an employee is barred from unionizing or is discriminated against based on a prohibited characteristic. Under post-1937 constitutional jurisprudence, government has broad prima facie power to define, declare, and prohibit such harms.[10] The modern state is not limited to imposing liability for actual harmful effects; it may declare legal rights designed to head off such effects. And it may frame them as benefits or rights for individual third parties. For example, to prevent the ultimate material harms of labor strife and unfair treatment of employees, government can declare rights of employees to unionize and can allow individuals to sue to enforce the right.

But just because government can prima facie regulate does not mean it can do so in ways that substantially burden religious exercise. The very point of the freedoms listed in the Bill of Rights, including religious freedom, is to place limits on actions otherwise within the government's power. If religious freedom confers no right to harm others, *and* the government can define anything it wishes as a harm, then the regulatory state will severely constrict religious freedom. For example, once Title VII and analogous laws defined various forms of discrimination as a legal harm to employees, religious organizations faced lawsuits triggering civil court review of their employment decisions concerning their clergy and other leaders. Their ability to choose their leaders was preserved only by a court-ordered religious exemption: the ministerial exception, affirmed in *Hosanna-Tabor Evangelical Lutheran Church & School v. EEOC*.[11]

The contraception mandate is a prime example of modern government declaring a legal entitlement unknown to the common law: guaranteed insurance coverage (for contraception) without cost-sharing. There may well be good reasons for creating such an entitlement (I personally think there are, in many cases). But it also creates new conflicts with the religious tenets of organizations and individuals. The government should not be able to win such conflicts simply by creating an entitlement and

6 Cutter v. Wilkinson, 544 U.S. 709, 720 (2005).

7 Eugene Volokh, *5C. RFRA Strict Scrutiny: The Interest in Protecting Newly Created Private Rights*, Volokh Conspiracy (Dec. 6 2013), http://volokh.com/2013/12/06/5c-rfra-strict-scrutiny-interest-protecting-newly-created-private-rights/, *archived at* http://perma.cc/MU4V-JMEC.

8 Pierre Bayle, *Philosophical Commentary on These Words of Christ: Compel Them To Come In, in* Pierre Bayle's Philosophical Commentary: A Modern Translation and Critical Interpretation 7, 167 (Amie Godman Tannenbaum trans., 1987).

9 Thomas Jefferson, Notes on the State of Virginia 159 (1784) (William Peden ed., 1954).

10 *See* Eugene Volokh, *A Common-Law Model for Religious Exemptions*, 46 UCLA L. Rev. 1465, 1521–26 (1999).

11 132 S. Ct. 694, 696 (2012).

defining its denial as a harm. The Supreme Court recognized this in analyzing the contraception mandate in *Hobby Lobby*. The extent to which a denial of a benefit materially affects others, the Court said, "will often inform the analysis of the Government's compelling interest and the availability of a less restrictive means" of advancing it.[12] But it cannot be, the Court added:

> that any burden on religious exercise, no matter how onerous and no matter how readily the government interest could be achieved through alternative means, is permissible under RFRA so long as the relevant legal obligation requires the religious adherent to confer a benefit on third parties. [If that were so, then by] framing any Government regulation as benefiting a third party, the Government could turn all regulations into entitlements to which nobody could object on religious grounds, rendering RFRA meaningless.[13]

A number of familiar, accepted religious accommodations involve clear effects on individual third parties. Some of these accommodations are constitutionally required, and all are constitutionally permissible. Draft exemptions shift harm from the pacifist to another person who must be drafted. The clergy-penitent privilege may shift harm to the crime or tort victim who loses the benefit of testimony.[14] The ministerial exception to non-discrimination laws, which *Hosanna-Tabor* unanimously held was constitutionally required, allows a religious organization to fire a minister for otherwise legally impermissible reasons. The religious-hiring exemption in Title VII, unanimously held permissible in *Corporation of Presiding Bishop v. Amos*, allows a religious organization to fire or refuse to hire employees outside of its own faith.[15] Protecting faith-based homeless shelters or food pantries from overly restrictive zoning regulations[16] can have some effect on neighbors' property values. And in cases, like *Sherbert v. Verner*, where a worker claims unemployment benefits after leaving a job because of a religious conflict, the claim for benefits increases an employer's rate of assessment for unemployment taxes.[17] These and other examples vindicate *Hobby Lobby*'s warning that in the era of the active state, many well-accepted protections would be eliminated if it were impermissible for religious freedom to affect the rights of third parties.

If religious freedom is to continue receiving strong weight in an era of greatly expanded government, the existence of some harm to other individuals cannot be enough in itself to deny exemption or accommodation. On the other hand, harms to others certainly are grounds for limiting religious freedom in a number of circumstances. I now discuss when preventing harms to others qualifies as a "compelling governmental interest" under RFRA and similar provisions; then I turn to Establishment Clause limits on accommodations.

II. Third-Party Harms and Compelling Interests: Factors to Consider

When is a harm to others a ground for limiting religious freedom, and what factors go into that determination? Under federal law and the law of more than 30 states, the rule is that substantial restrictions on religious practices should be relieved unless the government interest in the situation is quite strong—"compelling," in RFRA's terms—and no less restrictive means can be adopted without significantly compromising the government's interest. This standard, set forth in RFRA and its state law counterparts, is "a balancing test," but "with the thumb on the scale in favor of protecting constitutional rights."[18]

There is no algorithm to tell us what precisely counts as a compelling interest. All that one can do is identify the most common factors and give examples of the roles they play.[19] These various factors should be weighed to produce a balance with the thumb significantly on the side of religious freedom.

A. The Immediacy and Concentrated Nature of the Harm

It is one thing to say that a person cannot rely on religious grounds to assault another or trespass on her property. It is another thing to say that a person cannot ingest drugs at a worship service because some of the supply might be illegally trafficked and end up harming others. Both cases ultimately involve asserted harms to others, but the harms in the drug case are indirect, dependent on contingent chains of events, and diffused throughout society. In the modern state, government can regulate to prevent indirect or diffuse harms. But when application of the regulation substantially burdens religious exercise, the application should be subject to stringent questioning—certainly it should be under the RFRA standard—to ascertain that the harm will be severe and the regulation necessary to prevent it. Protecting religious freedom in these cases is relatively unproblematic because the costs of protection can be borne by the entire society, avoiding concentrated effects on any individual. Even many commentators who support significant limits on religious accommodations acknowledge that religious freedom is a "public good" and that "[t]he costs of permissive accommodations may be imposed on the public or one of its broad subsets."[20]

12 *Hobby Lobby,* 134 S. Ct. at 2781 n.37.

13 *Id.*

14 *See* Eugene Volokh, *3B. Would Granting an Exemption from the Employer Mandate Violate the Establishment Clause?*, Volokh Conspiracy (Dec. 4 2013) http://volokh.com/2013/12/04/3b-granting-exemption-employer-mandate-violate-establishment-clause/, *archived at* http://perma.cc/W3N-ZB25.

15 483 U.S. 327 (1987).

16 The very point of the Religious Land Use and Institutionalized Persons Act (RLUIPA), 42 U.S.C. §§ 2000cc to 2000cc-5, is to protect such activities. *See also* Chosen 300 Ministries v. City of Philadelphia, 2012 WL 3235317 (E.D. Pa. 2012) (entering preliminary injunction for feeding ministry under Pennsylvania RFRA).

17 374 U.S. 398, 399–400 (1963). *See, e.g.*, Volokh, *A Common-Law Model*, *supra* note 10, at 1513–14 & 1513 n.154 ("Unemployment compensation is generally experience-rated, so an employer's unemployment tax payments are tied to the number of claims the employer has had to pay out.").

18 Douglas Laycock, *The Religious Exemptions Debate*, 11 Rutgers J.L. & Relig. 139, 151–52 (2009).

19 These factors overlap with those in Christopher C. Lund, *Religious Exemptions, Third-Party Harms, and the Establishment Clause*, 91 Notre Dame L. Rev. 1375, 1376-81 (2016).

20 Frederick Mark Gedicks and Andrew Koppelman, *The Costs of the Public Good of Religion Should Be Borne by the Public*, 67 Vand. L. Rev. En Banc 185, 187 (2014), https://www.vanderbiltlawreview.org/wp-

In contrast, direct, particularized harms to an individual are more likely to justify denying an exemption. James Madison, a strong defender of free exercise, referred to such harms when he said that free exercise should prevail unless it "trespass[es] on private rights" (or, he added, "the public peace").[21] Religious freedom gives no one the right to commit direct invasions of another's life, liberty, or property—the historic framework of criminal or tortious acts.

B. Proximity to Core of Religious Freedom

But even actions with particularized effects on others must be protected in some circumstances, when the actions lie close to the core of religious exercise. We can see this, for example, by looking at employment disputes involving religious organizations.[22] If no action immediately affecting another individual should ever be exempted, then the ministerial exception would be inappropriate, since it allows a religious organization to deny employment to a specific individual. Likewise, it would be inappropriate, in any non-ministerial case, to permit a religious organization to prefer members of its faith in employment, since that would affect applicants of other faiths who were disfavored. But protections for religion-based hiring by religious organizations are well established. Courts have held that RFRA requires exemption in such situations,[23] and in *Amos* the Supreme Court unanimously upheld a statutory exemption against Establishment Clause challenge as applied to religious non-profits. In those situations, a religious organization's actions that immediately affect specific individuals should nonetheless be protected because they are part of the organization's internal governance and self-definition, which are at the core of its religious exercise.

Another way to approach this issue is to ask which persons count as "third parties," and which by contrast stand in a position internal to the religious community in question. *Hosanna-Tabor* points Religion Clause jurisprudence in this direction: it gives categorical protection to a religious organization's selection of leaders on the ground that this is "an internal church decision that affects the faith and mission of the church itself."[24] Ministers and would-be ministers are not third parties, but rather play or seek to play a role—a core role—in the religious institution in question. On such an internal matter, the Court deems it irrelevant that the law in question is generally applicable and that the religious organization's action has a negative effect on the individual minister.

One could say, although *Hosanna-Tabor* does not do so explicitly, that the minister has implicitly consented to the organization's power to set its internal policies concerning his employment. As the Court said in *Watson v. Jones* in 1872: "All who unite themselves to [a religious] body do so with an implied consent to [its] government, and are bound to submit to it."[25] Although this consent may sometimes be constructive, not actual, recognizing it helps support the sphere of freedom for religious organizations—what the Court has commended as "a spirit of freedom . . ., an independence from secular manipulation or control, in short, power to decide for themselves, free from state interference, matters of church government as well as those of faith and doctrine."[26]

This argument for religious organizational freedom applies not only to houses of worship and to employees who are members of the church. It also applies, presumptively at least, to non-members who agree to work for a religiously affiliated non-profit organization. The organization depends upon them to carry out its "faith and mission"; their loyalty to the mission is a crucial element of the exercise of religion. And they too have chosen to associate with the organization. As even scholars skeptical of accommodation have acknowledged, there is often a "reasonable expectation that employees who work for churches *and religious-affiliated non-profits* understand that their employers are focused on advancing a religious mission."[27] It is important to ensure that notice of the organization's religious nature and policies is clear.[28] But when it is, employees should presumptively be held to have consented, implicitly, to those policies and foundational principles, moving them from third-party to insider status.

On the other hand, employees and customers in the commercial marketplace are certainly third parties, and accordingly exemption from a generally applicable law should be more limited when they are affected. For-profit businesses differ from religious non-profits, as a general matter, for several reasons. First, non-profits that identify themselves as religiously affiliated are generally closer to the core of religious exercise than are for-profit businesses selling ordinary secular products.[29]

content/uploads/sites/89/2014/06/Gedicks-Koppelman-Response.pdf; Alan Brownstein, *Taking Free Exercise Rights Seriously*, 57 Case W. Res. L. Rev. 55, 129, 130 (2006) (arguing that "[c]onstitutional guarantees, such as freedom of speech or freedom of religion, are public, political goods" and "the state is often required to incur expenses in order to allow other rights such as freedom of speech to be exercised").

21 Letter from James Madison to Edward Livingston (July 10, 1822), reprinted in 9 The Writings of James Madison 98, 100 (Gaillard Hunt ed. 1910).

22 The stronger protection for claims at the core of religious exercise applies to individual as well as organizational claims. Protection will be more absolute for an individual's ability to attend church, or receive a religious education, than for the ability to follow her religion in for-profit employment—although the latter still must receive some protection in the balance.

23 *See, e.g.*, Porth v. Roman Catholic Dioc. of Kalamazoo, 532 N.W.2d 195, 199–200 (Mich. Ct. App. 1995) (applying RFRA, when it still applied to states, to exempt a Catholic school from a state religious-discrimination suit by a fifth-grade teacher).

24 *Hosanna-Tabor*, 132 S. Ct. at 707; see *id.* at 706 (referring to "the internal governance of the church" and "a religious group's right to shape its own faith and mission through its appointments").

25 Watson v. Jones, 80 U.S. 679, 729 (1872). For perceptive discussion of the "implied consent" doctrine, see Michael A. Helfand, *Religious Institutionalism, Implied Consent, and the Value of Voluntarism*, 88 S. Cal. L. Rev. 539 (2015).

26 Kedroff v. St. Nicholas Cathedral, 344 U.S. 94, 116 (1952).

27 Schwartzman et al., *supra* note 1 (emphasis added).

28 *See, e.g.*, Thomas C. Berg, *Partly Acculturated Religious Activity: A Case for Accommodating Religious Non-Profits*, 91 Notre Dame. L. Rev. 1341, 1371 (2016) ("Religious organizations that do not have explicit religious elements in their programs should make it reasonably apparent to employees—through the employee handbook or contract or some other means—that religious norms may apply.").

29 To speak of situations closer to or further from the core of free exercise is not to deny that religion plays a role even in the non-core situations. Rather, it

By their very identity, these non-profits carry out the mission of a religious community. And while religious communities have belief and worship at their core, their exercise cannot be confined to those categories: religious belief and identity have direct implications in service to others. Second, in extending further from the core of religious exercise, for-profit exemptions can affect vastly more persons: the religious non-profit sector covers perhaps 6–7 percent of jobs and wages, but the for-profit sector probably covers ten times that.[30] The state therefore has a heightened interest in regulating the for-profit sector to ensure that all people are able to participate fully in economic life.[31]

Moreover, the state has an increased interest in avoiding unfair commercial advantages for some market actors over others, especially when an exemption claim is less likely to be sincere—and sincerity of religious purpose can be presumed more safely with a religiously affiliated non-profit than with a commercial business.[32] Finally, expectations are different in the two contexts: while people should certainly expect that a religiously affiliated school or social service may run on religious principles, they have less reason to expect this of the ordinary commercial business.

This does not mean that businesses cannot have serious religious interests, or that the pursuit of profit is irreconcilable with religious exercise. The Supreme Court correctly held in *Hobby Lobby* that for-profit corporations could "exercise religion" and therefore bring claims under RFRA.[33] But it makes sense that there will be broader protections for religious non-profits, and narrower protections for businesses in the commercial market.

C. Severity of the Harm

Of course, a key question ultimately is the severity of the harm. Even a diffuse harm may be very serious: consider, for example, a serious threat to national security or public safety. Conversely, even when a harm is relatively individualized, it will not necessarily be significant enough to implicate a compelling governmental interest and override religious freedom. For example, consider the contraception mandate: the public health benefits of contraception are strong,[34] but employers were not stopping employees from getting contraception. The interest behind the coverage mandate was in ensuring effective access to contraception for each female employee no matter how modest her income or resources.[35] Contraception is often cheap and widely available, which would weaken the government's case under the compelling-interest component of RFRA.[36] The government's case for a compelling interest was stronger only because some contraceptives—those preferable or even necessary in some circumstances—cost considerably more, creating a significant expense for modest-income women.[37] I do not mean to adjudicate the government's interest here; my only point is that facts such as these should be considered under the case-by-case analysis mandated by RFRA.

The nature and severity of the harm is also a crucial question in the growing number of cases involving conflicts between religious freedom and gay rights: small wedding vendors declining to serve same-sex weddings, Catholic adoption agencies declining to place children with same-sex couples, religious colleges applying sexual-conduct policies to faculty, staff, or students. One harm in these cases that anti-discrimination law seeks to avoid is that the protected class might lack access to economic transactions and opportunities. That harm is clearly serious, and a religious provider would receive no exemption if its refusal significantly affected access. But in most cases it does not, because there are

recognizes, in the words of Elder Lance Wickman of the Mormon Church, that:

> in a pluralistic nation where religious people and institutions find themselves competing for influence with others having much different priorities and interests, we . . . have to prioritize. Defenders of religious freedom have to decide what is closer to the essential core of religious freedom and what is more peripheral. To do otherwise risks weakening our defense of what is essential. If everything that could even loosely be considered "religious" is treated as equally important, then effectively nothing religious is important.

Lance B. Wickman, *Promoting Religious Freedom in a Secular Age: Fundamental Principles, Practical Priorities, and Fairness for All* (July 7, 2016), http://www.mormonnewsroom.org/article/promoting-religious-freedom-secular-age-fundamental-principles-practical-priorities-fairness-for-all.

30 For the derivation of this number, see Thomas C. Berg, *Religious Accommodation and the Welfare State*, 38 Harv. J.L. & Gender 103, 127 n.23 (2015).

31 *See, e.g.*, Robert K. Vischer, *Do For-Profit Businesses Have Free Exercise Rights?*, 21 J. Contemp. Legal Issues 369, 391 (2013) ("The primary concern . . . is that for-profit corporations are so central to our ability to participate in modern life, including our ability to earn a livelihood. They are inescapable conduits for many goods deemed fundamental to our modern existence.").

These distinctions between for-profits and non-profits are certainly not absolute: some businesses (usually small ones) have a distinctively religious character personal to their owners, while some non-profits, such as hospital chains, act much like large commercial businesses. Non-profit versus for-profit status therefore should be only one among several factors, but it is generally a useful rule of thumb.

32 *See, e.g.*, *Amos*, 483 U.S. at 344 (Brennan, J., concurring) ("The fact that an operation is not organized as a profit-making commercial enterprise makes colorable a claim that it is not purely secular in orientation.").

33 *Hobby Lobby*, 134 S. Ct. at 2769–72 (noting that corporations often reflect the outlook of their owners, that many for-profit corporations follow moral norms and objectives, and that "there is no apparent reason why they may not further religious objectives as well").

34 *Id.* at 2799 (Ginsburg, J., dissenting) ("The coverage helps safeguard the health of women for whom pregnancy may be hazardous, even life threatening. And the mandate secures benefits wholly unrelated to pregnancy, preventing certain cancers, menstrual disorders, and pelvic pain.") (citations omitted).

35 *See, e.g., id.* at 2789.

36 *See, e.g.*, Megan McArdle, *Sell Birth Control Over-the-Counter*, Bloomberg View, Sept. 10, 2014, http://www.bloombergview.com/articles/2014-09-10/sell-birth-control-over-the-counter, *archived at* http://perma.cc/M6ED-2WHQ ("Generic birth-control pills are a cheap, regular expense used by many millions of people, exactly the sort of thing that insurance is not designed for.").

37 *See, e.g.*, *Hobby Lobby*, 134 S. Ct. at 2800 (Ginsburg, J., dissenting) (the cost of an IUD, which is "significantly more effective" than other methods, is "nearly equivalent to a month's full-time pay for workers earning the minimum wage"); McArdle, *supra* note 36 (noting the higher costs of IUDs).

ample alternative providers: many adoption agencies in Massachusetts willing to serve same-sex couples,[38] and many colleges for LGBT students to attend that do not have conduct policies that would conflict with their sexuality.

Even in the for-profit sphere, some courts have been willing to exempt a small provider of services—for example, a religiously devout landlord declining to rent to an unmarried, cohabiting male-female couple—if an exemption would not "significantly imped[e] the availability of rental housing for people who are cohabiting."[39] By contrast, other courts have held that government has a compelling interest in preventing each and every act of discrimination, regardless of its effect on access. The Alaska Supreme Court said that the state had a compelling "transactional interest" in preventing each act of discrimination "based on irrelevant characteristics"—regardless of whether it materially impeded a cohabiting couple's access to housing—because such discrimination "degrades individuals [and] affronts human dignity."[40]

The transactional/dignitary harm to same-sex couples in commercial cases can be viewed as serious: it can involve surprise and, in public settings, embarrassment or humiliation in front of others. On the other hand, the dignitary harm from the denial often occurs solely through its "communicative impact"—the impact of the message of disapproval it sends—which in other contexts cannot qualify as a justification for overriding First Amendment rights.[41] And same-sex couples are already aware that some people around them do not approve of their relationships. Under a RFRA, I would protect for-profit objectors in a narrow set of cases: sole proprietors or small-business owners providing personal services to facilitate, in a specific way, a ceremony or relationship to which they object, in cases where there are ample alternatives and thus little effect on access. These cases include the small landlord who objects to renting to unmarried male-female cohabiting couples, the small wedding photographer who declines to provide services for a same-sex commitment ceremony,[42] or the counselor who declines to counsel cohabiting or same-sex couples. These objectors plausibly feel the most direct personal responsibility for their contribution to others' actions, and the sanctions imposed by anti-discrimination law threaten to drive them from their business.[43]

Whatever courts conclude about those cases, two points should be clear. First, the relatively cautious approach to exemptions in the for-profit sphere means that anti-discrimination exemptions should not extend beyond individuals and small businesses who would otherwise have to provide services directly to facilitate marriages or relationships to which they conscientiously object.[44] The arguments for such a carefully defined small-business exception do not justify exemption for much larger businesses or for those that have market power (for example, in lightly populated areas). Nor should we exempt the objector who refuses service in a context that has no real nexus to the behavior she opposes. Exemption may extend to providers of services specifically tied to the religious objection (the wedding photographer refusing to use her art to sanction what she considers a sinful union), but not to those who seek to avoid dealing with individuals whose unrelated behavior is considered objectionable (the restaurant refusing to provide a table to gay customers). These distinctions are worth making if a jurisdiction wants to value both religious freedom and same-sex family equality.[45]

Second, even if the harm from refusal is deemed per se serious enough to reject exemptions in the for-profit sphere, the same should not apply to religious non-profits, which merit stronger protection. If a religious non-profit's denial of service is unprotected even when it has no meaningful effect on access, then the organization will be severely restricted in its ability to

38 *See* Dale Carpenter, *Let Catholics Discriminate*, Metro Weekly (Mar. 29, 2006), http://www.metroweekly.com/2006/03/let-catholics-discriminate/ ("Gay couples could still adopt through dozens of other private agencies or through the state child-welfare services department itself, which places most adoptions in the state.").

39 Attorney Gen. v. Desilets, 636 N.E.2d 233, 241 (Mass. 1994) (applying compelling-interest test under state constitution).

40 Swanner v. Anchorage Equal Rights Com'n, 874 P.2d 274, 283 (Alaska 1994).

41 *See, e.g.*, Texas v. Johnson, 491 U.S. 397, 406 (1989) ("expressive conduct" such as flag-burning may not be prohibited when the law is "'directed at the communicative nature of [the] conduct'") (emphasis and quotation omitted); *accord* United States v. Eichman, 496 U.S. 310, 317 (1990) (government action may not suppress First Amendment conduct "out of concern for its likely communicative impact").

42 *See, e.g.*, Elane Photography LLC v. Willock, 309 P.3d 53 (N.M. 2013).

43 *See, e.g.*, In the Matter of: Melissa Elaine Klein, dba Sweetcakes by Melissa, 2015 WL 4868796 (Ore. Bur. Lab. & Ind. 2015) ($135,000 in emotional-distress damages imposed on cakeshop); *Elane Photography*, 309 P.3d 53 ($6,600 in attorney's fees imposed on photographer, with no proof of actual damages). The *Sweetcakes* shop received contributions to defray their costs, and the plaintiff couple in *Elane Photography* waived the award, *see* 309 P.3d at 60. But there is no guarantee the same thing will happen in subsequent cases.

44 This limit on a for-profit exemption should not apply when the law in question is not neutral or generally applicable: that is, when it singles out religious objections for regulation, like the rules imposed on pharmacies in *Stormans, Inc. v. Wiesman*, 794 F.3d 1064 (9th Cir. 2015), cert. denied, 136 S. Ct. 2433 (2016). Even with respect to large businesses, there is no constitutional justification for targeting religious reasons for denying service while allowing multiple other reasons, as the state did in *Stormans*. *See* Stormans, Inc. v. Selecky, 844 F. Supp. 2d 1172 (W.D. Wash. 2012) (documenting the selective regulation and the targeting of religion).

45 Because a small number of states have already begun to require for-profit businesses to cover abortions, it is worth noting that protection of for-profits ought to be broader in that context than in the gay-rights context, for two reasons. First, objections to facilitating abortion unquestionably go only to a particular procedure, while broad objections to serving same-sex couples may go beyond a particular ceremony or activity and become objections to LGBT customers as persons—for example, refusing not just to provide services for a wedding, but to serve a same-sex couple in a restaurant. Second, the pattern of protections in federal and state law for abortion objectors has been uniquely strong, covering a wide range of health-care providers, even large for-profit entities like health insurers—and reflecting the judgment that it is an especially serious burden on conscience to require a person to assist in what he believes to be the unjustified killing of a human being. For documentation of the strength of abortion-conscience protections, see Mark L. Rienzi, *The Constitutional Right Not to Kill*, 62 Emory L.J. 121, 147–52 (2012); Brief of Democrats for Life of America and Bart Stupak as Amici Curiae in Support of Hobby Lobby and Conestoga et al., *Burwell v. Hobby Lobby Stores, Inc.*, 134 S. Ct. 2751 (2014), at 7–13, *available at* http://www.americanbar.org/content/dam/aba/publications/supreme_court_preview/briefs-v3/13-354-13-356_amcu_dfla.authcheckdam.pdf.

follow its tenets and identity. As already noted, religious schools and social services are generally closer to the core of religious life than are for-profit businesses, and the element of surprise that may result from a refusal in the for-profit marketplace does not apply when employees or clients deal with a charity that is known to be religious.

We might sum up this section by noting that the seriousness of effects on others can be mitigated by two factors: notice of the religious claimant's policy and ready alternative providers of services. In the non-profit context, publicly identified religious organizations by nature give notice of their identity, and they may give notice of specific policies as well. Assuming that notice exists, then only in those few cases where religious non-profits hold market power is there a clear argument for a compelling interest in denying exemption. With for-profit businesses, there also may be ample alternatives, but exemptions should be narrower—not nonexistent, but narrower—in part because the lack of inherent notice makes harmful surprise more likely, and in part because of the increased interest in ensuring everyone's access to the commercial marketplace.

Finally, under RFRA, the government must show not only that the burden it has imposed on religion serves a compelling interest, but also that it does so by the least restrictive means.[46] *Hobby Lobby* held that the mechanism for coverage by the insurer or third-party administrator was an available, less restrictive means. That mechanism was practicable because, by the government's own calculations, insurance coverage of contraception saves costs to insurers on net by avoiding costs from pregnancies.[47]

The majority was less clear on whether the option of increasing public funding of contraception would constitute an available less restrictive means: Justice Kennedy, the crucial fifth vote, expressed doubt in his separate opinion that RFRA would mandate that option.[48] Kennedy may have been influenced by the fact that there seemed to be no chance Congress would ever pass such funding. But in many cases, the government could increase access to a good or service by increasing its subsidies or providing tax incentives to encourage manufacturers or distributors to provide it at lower cost.[49] By these mechanisms, the government would take the impact of an employer's religious-freedom right on a relatively small number of employees and diffuse it among the far larger taxpaying public.[50]

The advantage of focusing on "less restrictive means" is that the government can develop such alternatives based on pragmatic considerations—and the RFRA framework encourages such solutions. Under pressure from lawsuits, the government came up with a creative mechanism to accommodate objections by religious non-profits; in hearing and deciding the *Hobby Lobby* case under RFRA, the Court likewise turned to this mechanism to accommodate objections by closely-held for-profits. Without RFRA's mandate to explore means of accommodating religious objections, there would have been little or no legal pressure for the administration, or the Court, to engage in this problem solving.

III. Establishment Clause Limits

When the question is whether the Establishment Clause bars an exemption meant to protect religious exercise, the factors just discussed apply—but they should be weighed with deference to the exemption. The clause places some outside limits on how far a statutory exemption may go, but those limits should be lenient. Because exemptions are crucial to preserving religious freedom in the active state, stringent judicial policing of their permissibility is inappropriate. An exemption should not be struck down unless the direct, immediate burdens it imposes on others are clearly disproportionate to the legal burdens it removes from religious practice.

A. Reasons for a Deferential Establishment Clause Limit

It is clear that an exemption provision is not invalid simply because it singles out religious practice for protection. Two rulings decisively reject that proposition by upholding a statutory accommodation unanimously: *Amos*, approving Title VII's exemption of religious organizations from liability for religious discrimination;[51] and *Cutter*, affirming the provision of the Religious Land Use and Institutionalized Persons Act (RLUIPA) that protects state prisoners' exercise of religion unless the prison can show a compelling interest in restricting it.[52] In *Amos*, the Court said that "there is ample room for accommodation of religion," that a law does not advance or sponsor religion "merely because it *allows* churches to advance religion," and that "when government acts with the proper purpose of lifting a regulation that burdens the exercise of religion, we see no reason to require that the exemption comes packaged with benefits to secular entities."[53]

However, there are Establishment Clause limits on exemptions, and third-party harms figure in those limits. *Estate of Thornton v. Caldor, Inc.*,[54] for example, invalidated a statute imposing an absolute duty on employers to grant an employee's request for his Sabbath day off.[55] And as already noted, *Cutter*, while upholding RLUIPA's prison provisions, laid out a three-part Establishment Clause test that includes whether the accommodation in question takes "adequate account of the burdens [it] may impose on nonbeneficiaries."[56]

46 *Hobby Lobby*, 134 S. Ct. at 2759.

47 *See id.* at 2782 n.38.

48 *See id.* at 2786 (Kennedy, J., concurring).

49 *See, e.g.*, Korte v. Sebelius, 735 F.3d 654, 686 (7th Cir. 2013) (arguing that "[t]he government can provide a 'public option' for contraception insurance; it can give tax incentives to contraception suppliers to provide these medications and services at no cost to consumers; it can give tax incentives to consumers of contraception and sterilization services," and that "[n]o doubt there are other options").

50 *See, e.g.*, Brownstein, *supra* note 20, at 128–29 (discussing means of diffusing effects among larger public).

51 *Amos*, 483 U.S. at 339.

52 *Cutter*, 544 U.S. at 726.

53 *Amos*, 483 U.S. at 337–38 (emphasis in original).

54 472 U.S. 703 (1985).

55 *Id.* at 708–10.

56 *Cutter*, 544 U.S. at 720.

The *Cutter* test, however, should not be a stringent one. Under it, the burden the accommodation imposes on others is not determinative: it must be weighed, if only in a rough way, against the burden the accommodation removes from sincere religious practice. For several reasons, only a great disparity between the two factors should suffice to disapprove the accommodation.

1. Theoretical/Historical Foundations

First, the theoretical and historical foundations for calling an accommodation an establishment are shaky, and they support only a modest Establishment Clause limit. Historically, exemptions of religious practice from government regulation were not typical components of establishment: exemptions were created to protect minority faiths, not the established majority. "Exemptions protect minority religions," Douglas Laycock has shown, "and they emerged only in the wake of toleration of dissenting worship," as part of "a political commitment to free exercise," not to establishment.[57]

Gedicks and Van Tassell argue that "[p]ermissive accommodations that require unbelievers and nonadherents to bear the costs of someone else's religious practices constitute a classic Establishment Clause violation."[58] They point out that classic establishments "imposed legal and other burdens on dissenters and nonmembers that [they] did not impose on members."[59] But this analogy is weak. Historic establishments pressured dissenters to attend the favored church or required them to pay taxes for its support.[60] Such requirements differ from regulatory exemptions in the very ways that are at issue. Compulsion to attend a church is compulsion to engage in a religious practice, something that no regulatory exemption requires. Required tax support for the favored religion removes no legal burden on that faith and thus serves no free exercise interest. By contrast, most exemptions from regulation serve free exercise interests. To cite forced worship or tax support as analogies to condemn exemptions begs the key questions.

Regulatory exemptions and compulsory tax-generated support are treated very differently in our law. The Court has said there is an especially strong, "historic and substantial," Establishment Clause interest in preventing tax support for clergy.[61] If regulatory exemptions were like tax support, then the clergy context would be the most problematic one for exemptions. But the law is exactly the opposite: the ministerial exemption was affirmed unanimously in *Hosanna-Tabor*, and within its domain it is absolute, the strongest religious-freedom exemption in American law. Clergy and worship services present the strongest context for exemption, even as they present the most questionable context for tax support. The reason is that exemptions, unlike tax support, serve interests in religious autonomy, for which clergy and worship are the core contexts.

A more pertinent historical case concerning the constitutionality of religious exemptions is the original "benefit of clergy," the arrangement by which clerics in the medieval church were immune from civil jurisdiction—triable only in church courts—for any felonies they committed.[62] King Henry II's attempt to shrink this privilege and prosecute "criminous clerks" in royal courts for rapes, murders, and thefts lay at the core of his confrontation with Archbishop Thomas Becket in the mid-12th century.[63] Although benefit of clergy changed drastically in form before the American colonies were founded,[64] its original form can easily be seen as a feature of establishment.[65] Unlike compelled worship or tax support, benefit of clergy involved the feature relevant to accommodations: exemption of religious actors from secular regulation when they had caused harm to others.

But treating benefit of clergy as a feature of establishment does not mean rejecting most modern exemptions, for there are multiple differences between the two. First, benefit of clergy was for the favored church (the medieval Catholic Church, then the Church of England after the Reformation).[66] Second, it shielded wrongdoers from state jurisdiction even when there was no particularized conflict between the law in question and the demands of faith. Neither clerics nor the church presented any claim that faith or mission called them to engage in felonies. Rather, the church asserted a purely jurisdictional claim: autonomy to resolve cases in its own courts. Such a claim is strong with respect to internal matters of church governance; the ministerial exception, as affirmed in *Hosanna-Tabor*, essentially gives the church categorical autonomy over the selection of church leaders. But a religious organization cannot have such absolute protection in contexts where third parties are significantly affected. In those contexts, exemptions should—and the vast majority of them do—rest on the existence of a particularized conflict between the civil law and a religious claimant's tenets or identity.

57 Douglas Laycock, *Regulatory Exemptions of Religious Behavior and the Original Understanding of the Establishment Clause*, 81 Notre Dame L. Rev. 1793, 1796, 1803 (2006); *accord* Michael W. McConnell, *The Origins and Historical Understanding of Free Exercise of Religion*, 103 Harv. L. Rev. 1409, 1511 (1990) ("There is no substantial evidence that [religious] exemptions were considered constitutionally questionable.").

58 Gedicks & Van Tassell, *supra* note 1, at 363.

59 *Id.* at 362 (citing Michael W. McConnell, *Establishment and Disestablishment at the Founding, Part I: Establishment of Religion*, 44 Wm. & Mary L. Rev. 2105, 2144–46 (2003)).

60 McConnell, *supra* note 59, at 2144–46.

61 Locke v. Davey, 540 U.S. 712, 725 (2004); *id.* at 722 ("[W]e can think of few areas in which a State's antiestablishment interests come more into play.").

62 *See, e.g.*, George W. Dalzell, Benefit of Clergy in America & Related Matters 9–15 (1955); Theodore F.T. Plucknett, A Concise History of the Common Law 439–41 (5th ed. 1956).

63 Harold J. Berman, Law and Revolution: The Formation of the Western Legal Tradition 255–64 (1983); Plucknett, *supra* note 62, at 439.

64 Dalzell, *supra* note 62, at 16–23; Plucknett, *supra* note 62, at 441.

65 For example, an Indiana court in 1820 rejected a convicted murderer's claim to a reduced sentence under benefit of clergy, saying: "The benefit of clergy . . . originated with that of sanctuary in the gloomy days of popery. . . . The statutes of England on the subject are local to that kingdom . . . and are certainly not adopted as the laws of our country." Dalzell, supra note 62, at 238 (citing *Fuller v. State,* 1 Blackf. 66).

66 *See id.* at 19 (noting that after the Reformation, "[English]-born Catholic priests returning from abroad . . . were hanged without benefit of clergy" unless they took "an oath [renouncing papal loyalty] to which they could not possible subscribe").

Finally, benefit of clergy blocked the government from preventing serious, direct harms to the person and property of other individuals: murder, rape, theft. No one argues today that religious freedom shields acts causing such basic harms. Exemptions today concern laws that reflect the far more extensive aims of the modern welfare state. Thus, any analogy to benefit of clergy merely returns to the problem of defining the relative limits of regulation and the countervailing right to free exercise of religion. The proper balance requires recognizing modern government's expanded power, but not simply deferring to its assertions of what constitutes harm.[67]

2. Deference to Legislative Judgments

Second, when the question is whether a statutory exemption is permissible, the policy of deference to government's balancing of goals cuts in favor of the exemption. If modern regulators have leeway to define legal harms in order to pursue varying interests, then they should have leeway to protect religious freedom among those interests. It would make little sense, for example, to say that a state that recognized same-sex marriage could not simultaneously exempt religious adoption agencies or counseling organizations, in order to balance the two rights. Why is it any different if the legislature creates exemptions in response to a court decision ordering same-sex marriage than if the legislature enacts the accommodation at the time it recognizes marriage legislatively?

The issue of exemptions from newly-created rights has generated an exchange of accusations of question-begging. Before the *Hobby Lobby* decision, some commentators argued that exempting employers from the contraception mandate would create no legal burden on employees because RFRA meant that the mandate never gave the employees a right in the first place.[68] Others responded, correctly I think, that such "baseline" arguments begged the question whether applying RFRA would violate the Establishment Clause by making the decision to include someone within a legal right contingent on another person's religious exercise.[69] But this response also begs a question: Why doesn't the legislature that creates a legal right have discretion, in either the same statute or a separate one, to balance that right against the religious freedom of others affected by it?

The expansion of regulation in the modern state has narrowed the effective scope of the free exercise of religion, and within some range government clearly has discretion to do so. But the expanded state should likewise narrow the scope of the non-establishment rule. The government should similarly have discretion to reduce the effects that its own expansion has on religious freedom—including effects caused by the declaration of new legal harms to third parties. Otherwise, the expansion of the state's role would be a one-way ratchet, giving government discretion to shrink free exercise, but no discretion to preserve it.

Establishment Clause review of the balance between religious accommodation and other rights should not be stringent. As Michael McConnell has observed, "when legislatures adjust the benefits and burdens of economic life among the citizens, they regularly impose more than a de minimis burden for the purpose of protecting important interests of the beneficiary class": consider, for example, the duty of reasonable accommodation of disabilities.[70] The legislature should have as much latitude to protect religion as it has to protect these other important values.[71] Moreover, because "[a]ny comparison of benefits and burdens will admittedly suffer the problem of comparing apples and oranges," the analysis cannot be highly rigorous: "The courts should be satisfied if they have examined the legislative accommodation and determined that the burden on nonbeneficiaries is not obviously disproportionate. Deference to legislative judgment is appropriate here; secular economic interests are not under-represented in the political process."[72]

B. Application and the Case Law

The "significantly disproportionate burdens" standard advocated here gives the best account of the Establishment Clause case law. The exemption for religion-based hiring in *Amos* allowed the organization to discharge an individual from his job—unquestionably a significant, individualized burden. Yet the Court unanimously upheld it because, as Justice Brennan later wrote, it "prevented potentially serious encroachments on protected religious freedoms."[73] Critics of accommodation concede, as they must, that exemptions for religiously affiliated non-profits are permissible even when they significantly affect identifiable individuals.[74] Courts give—and should give—significant weight to the free exercise interests that support exemptions.

The two Supreme Court decisions invalidating accommodations are consistent with a narrow rule of invalidity. *Caldor*, which as already noted struck down a state law requiring private employers to give employees their Sabbath day off, involved several features that made it very likely the costs imposed on others

67 The three features of medieval benefit of clergy—denominational favoritism, no particularized burden removed from religion, and permitting serious direct harms to others—are the indicia in the *Cutter* test for an impermissible accommodation. *See Cutter*, 544 U.S. at 720.

68 Kevin C. Walsh, *A Baseline Problem for the "Burden on Employees" Argument Against RFRA-Based Exemptions from the Contraceptives Mandate*, Mirror of Justice (Jan. 17, 2014), http://mirrorofjustice.blogs.com/mirrorofjustice/ 2014/01/a-baseline-problem-for-the-burden-on-employees-argument-against-rfra-basedexemptions-from-the-contr.html. For a somewhat analogous argument, see Marc DeGirolami, *On the Claim that Exemptions from the Mandate Violate the Establishment Clause*, Mirror of Justice (Dec. 5, 2013), http://mirrorofjustice.blogs.com/mirrorofjustice/2013/12/exemptions-from-the-mandate-do-not-violate-the-establishment-clause.html.

69 Frederick Mark Gedicks & Andrew Koppelman, *Invisible Women: Why an Exemption for Hobby Lobby Would Violate the Establishment Clause*, 67 Vand. L. Rev. En Banc 51, 59-60 (2014), *available at* https://www.vanderbiltlawreview.org/wp-content/uploads/sites/89/2014/03/Gedicks-and-Koppelman_Invisible-Women.pdf.

70 Michael W. McConnell, *Accommodation of Religion: An Update and a Response to the Critics*, 60 Geo. Wash. L. Rev. 685, 704 (1992).

71 *Id.*

72 *Id.* at 705.

73 Tex. Monthly, Inc. v. Bullock, 489 U.S. 1, 18–19 n.8 (1989) (Brennan, J., plurality opinion) (citing *Amos*, 483 U.S. 327).

74 *See, e.g.*, Gedicks and Van Tassell, *supra* note 1, at 368 (acknowledging that the religious-hiring exemption "created a substantial burden [on an employee] where none previously existed").

would outweigh the burdens removed from religion. First, the statute gave employees an unqualified right regardless of the cost to employers and other employees: it reflected "an unyielding weighting in favor of Sabbath observers over all other interests."[75] Thus the effects on others were potentially large, and the statute showed no respect for their interests. Second, the case arose in a commercial context where, as already noted, the interest in making room for everyone, without unfair advantages for any, requires special care in the structuring of exemptions.[76] *Caldor* provides little ground for striking down exemptions protecting non-profit organizations whose religious character is apparent.[77]

The need for limits in the sphere of commercial businesses is shown by the recent federal court decision invalidating Mississippi's statutory accommodation of objectors to LGBT rights on the ground that the accommodation violated the Equal Protection and Establishment clauses.[78] Under both clauses, the court said that the breadth of the law made it unconstitutional.[79] Section 5 of the act allowed any closely-held business to refuse to provide services to a same-sex wedding, regardless of the business's size or the effect its refusal would have on same-sex couples' access to services. Section 6 allowed any such business, again no matter how large, to require that transgender employees use the bathroom of their biological sex at birth.[80]

Some parts of the judge's opinion were improperly hostile to religious accommodation. But he had a fair point about the breadth of this statute in the commercial sphere. When a group of scholars, including me, proposed "marriage conscience" provisions in various states to accompany recognition of same-sex marriage, we limited the size of the businesses that would be protected, and we included an override for cases where exemption would cause a marrying couple substantial hardship.[81] Our numerical ceiling was five employees, which was surely lower than is constitutionally necessary; but some meaningful ceiling and/or hardship override are necessary. At any rate, the Mississippi decision shows the need to be careful in drafting religious-freedom legislation in the government and commercial spheres.

A third feature of *Caldor* is that the burden on employees' religion that the statute removed had been imposed not by the state, but rather by private employers. Thus, as Justice O'Connor put it, the statute "[was] not the sort of accommodation statute specifically contemplated by the Free Exercise Clause."[82] The strongest case for government to remove a burden on religion is when government itself has created the burden, implicating the Free Exercise Clause's special concern for religious freedom against the government. In *Caldor*, with that constitutionally grounded justification absent, the statute was simply reordering interests among private employees, which made the Court more willing to ask whether the balance the statute struck was even-handed.

For the same reasons, it is misplaced to suggest, as some commentators have, that the Establishment Clause should permit only "de minimis" effects on others.[83] The Supreme Court has adopted that standard to limit accommodation of religious employees' practices under Title VII of the Civil Rights Act;[84] but the analogy to most other exemption cases is entirely inapt. The de minimis standard did not interpret the Constitution; it interpreted (correctly or not) an anti-discrimination statute that does not facially require exempting employees from generally applicable work rules (unlike federal or state RFRAs, which explicitly requires exemptions). When the Court in *Caldor* actually described what burdens on others render an accommodation unconstitutional, it referred to an "unyielding weighting" of religious over secular interests,[85] which is virtually the opposite of saying that a mere "de minimis" burden on a secular interest outweighs any burden on a religious interest.

Moreover, because the Title VII accommodation provision, like the statute in *Caldor*, does not promote the constitutionally grounded interest in preventing government-imposed burdens, the Justices may have been more willing to question whether the adjustments the provision makes among employees would be even-handed. Finally, the Title VII accommodation provision operates mostly in the context of ordinary commercial businesses. With respect to religiously affiliated organizations, by contrast, a de minimis standard is irreconcilable with well-established exemptions—like the religious-hiring protection unanimously upheld in *Amos*—that have significant effects on others.

The other anti-accommodation decision is *Texas Monthly v. Bullock*, [86] which struck down a sales-tax exemption for religious publications. There three justices joined a plurality opinion finding that the cost the exemption shifted to others—a higher share of tax liability if tax revenues were to remain constant—outweighed the burdens removed from religion.[87] This weighing could be questioned, because although the incremental burden

75 *Caldor*, 472 U.S. at 709–10.

76 *See supra* notes 29-33 and accompanying text.

77 Even Professors Schwartzman, Schragger, and Tebbe—skeptics of accommodation—at one point suggest only that non-profit exemptions raise establishment issues in "special circumstances" such "as where a religious non-profit (e.g., a hospital) monopolizes a local market." Schwartzman et al., *supra* note 1.

78 Barber v. Bryant, ___ F. Supp. 3d, 2016 WL 3562647 (S.D. Miss. June 30, 2016).

79 *Id.* at *18-*23 (equal protection); *id.* at *31-32 (Establishment Clause).

80 HB 1523, http://billstatus.ls.state.ms.us/documents/2016/html/HB/1500-1599/HB1523SG.htm.

81 For the latest version, from fall 2013, see Thomas Berg, *Archive: Memos/Letters on Religious Liberty and Same-Sex Marriage*, Mirror of Justice (Aug. 2, 2009), http://mirrorofjustice.blogs.com/mirrorofjustice/2009/08/memosletters-on-religious-liberty-and-samesex-marriage.html.

82 *Caldor*, 472 U.S. at 712 (O'Connor, J., concurring).

83 *See, e.g.*, Nelson Tebbe et al., *How Much May Religious Accommodations Burden Others?*, http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2811815 (forthcoming in Elizabeth Sepper et al., Law, Religion, and Health in the United States (Cambridge Univ. Press, forthcoming 2017)).

84 Trans World Airlines v. Hardison, 432 U.S. 63, 84 (1977) ("To require TWA to bear more than a *de minimis* cost in order to give [a Sabbatarian employee] Saturdays off is an undue hardship.").

85 *Caldor*, 472 U.S. at 710.

86 489 U.S. 1 (1989).

87 *Id.* at 14–20 (Brennan, J., plurality opinion).

from a small tax on each sale of a religious periodical is relatively small, so is the cost shifted to any one taxpayer: *Texas Monthly* involved a diffuse rather than concentrated burden on others. In any event, the concurring justices objected that this rationale for invalidating the exemption was too broad. They focused on the fact that the statute favored religious messages and publications, which among other things implicated content-neutrality principles under the Free Speech and Free Press Clauses.[88] This rationale does not affect most exemptions, because most do not involve cases of speech.

IV. Conclusion

In the past, some judges and commentators have suggested that any exemption specifically for religious interests is invalid favoritism for religion.[89] That analysis has been properly rejected: a distinctive concern for free exercise is part of our constitutional text and national tradition. It is more justifiable to define the limits of religious accommodation on the basis of significant harms that it may cause to nonconsenting third parties—and we can expect continued litigation over these questions in the future. But rules against third-party harms cannot be stringent. Since the modern state can define virtually any effect as a prima facie harm, there must be meaningful limits on these definitions as they apply to religious conduct, or else government's expansion will crowd out religious exercise in many sectors of life. This is so both when a religious claimant seeks exemption under a RFRA or a state constitutional provision, and when an exemption enacted by the legislature is challenged as unconstitutional. Courts deciding cases, and legislatures considering statutory exemptions, should consider the principles outlined here as a framework for taking religious freedom seriously while recognizing other persons' interests.

88 *See id.* at 25–26 (White, J., concurring in the judgment) (concluding that "the proper basis for reversing the judgment below" was that exemption violated Free Press Clause by discriminating among publications based on content); *id.* at 28–29, 27 (Blackmun, J., concurring in the judgment) (concluding that exempting only religious publications unconstitutionally gave "preferential support for the communication of religious messages," but criticizing Brennan's broader rationale for "subordinating the Free Exercise value").

89 *See, e.g.*, City of Boerne v. Flores, 521 U.S. 507, 536-37 (1997) (Stevens, J., concurring); Mark Tushnet, *"Of Church and State and the Supreme Court": Kurland Revisited*, 1989 Sup. Ct. Rev. 373.

The FCC Forgot Something in Piecing Together Its Complex Proposal for Broadband Privacy Regulation: Consumers

By Rosemary C. Harold

Note from the Editor:

This article discusses the FCC's proposed rules for broadband privacy, and criticizes them for departing from the FTC's tried-and-true regulation practices and for insufficiently considering consumers' expectations and needs.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the authors. Whenever we publish an article that advocates for a particular position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article. We also invite responses from our readers. To join the debate, please email us at info@fedsoc.org.

• *Protecting the Privacy of Customers of Broadband and Other Telecommunications Services*, NPRM, 31 FCC Rcd 2500 (2016), https://apps.fcc.gov/edocs_public/attachmatch/FCC-16-39A1_Rcd.pdf.

• Letter from Bernie Sanders, Ed Markey, Elizabeth Warren, Richard Blumenthal, Al Franken, Patrick Leahy, and Tammy Baldwin, Senators, to Tom Wheeler, FCC Chairman, *available at* http://www.markey.senate.gov/imo/media/doc/Letter%20--%20FCC%20Privacy%20%207-7-16.pdf.

• Testimony of Prof. Paul Ohm, Subcommittee on Communications and Technology, Committee on Energy and Commerce, U.S. House of Representatives (June 14, 2016), https://ecfsapi.fcc.gov/file/106190685108718/PaulOhmTestimony06142016HouseSubCommTech.pdf.

• Reply Comments of Prof. Paul Ohm, Federal Communications Commission (June 22, 2016), https://ecfsapi.fcc.gov/file/10622254783425/OhmReplyComments.pdf.

• Natasha Lomas, *As FCC considers new broadband privacy rules, report urges wider user data safeguards*, TechCrunch (Mar. 23, 2016), https://techcrunch.com/2016/03/23/as-fcc-considers-new-broadband-privacy-rules-report-urges-wider-user-data-safeguards/.

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Introduction

Readers who wade through the Federal Communications Commission's 100+ page *Privacy Notice*—the agency's proposed rules for broadband internet access providers ("ISPs" or "broadband providers")[1]—may find it difficult to spot a strong connection between those proposals and the internet privacy protections familiar to consumers today. There is a reason for that: The FCC's proposals reflect its regulatory past, not consumers' online present.

The FCC opened its broadband privacy rulemaking proceeding in March 2016 and may be on track to adopt new rules before the November elections. This is a remarkably speedy pace, especially given the complexity of the issues and the degree to which the FCC's proposals diverge from the Federal Trade Commission's more flexible privacy regulations that have governed ISPs—and all other players in the online ecosystem—for years. The FTC's expertise in protecting consumer privacy dates back to the 1970s, well before the internet emerged; since then, the FTC has worked methodically to develop and enforce privacy requirements that center on consumers' reasonable expectations that certain information, such as health and financial data, is more sensitive and therefore warrants more protection than, say, data showing shopping habits.[2] Today, the FTC places significant emphasis on a business enterprise's disclosure of its privacy practices to consumers and the enterprise's adherence to its own promises.[3] This approach covers essentially all consumer-facing companies in the online marketplace, including "edge providers" such as browsers, search engines, online retailers, and social media. Americans who use the internet today are accustomed to the online privacy standards the FTC has fostered.[4]

The FCC, on the other hand, is a newcomer to internet privacy issues. Although the agency has enforced statute-specific privacy requirements on the original "common carriers" under

1 *Protecting the Privacy of Customers of Broadband and Other Telecommunications Services*, NPRM, 31 FCC Rcd 2500 (2016) [hereinafter *Privacy Notice*], https://apps.fcc.gov/edocs_public/attachmatch/FCC-16-39A1_Rcd.pdf.

2 *Protecting Consumer Privacy*, Fed. Trade Comm'n (FTC), https://www.ftc.gov/news-events/media-resources/protecting-consumer-privacy (last visited Aug. 31, 2016) (history of FTC privacy enforcement); Protecting Consumer Privacy in an Era of Rapid Change: Recommendations For Businesses and Policymakers, Fed. Trade Comm'n 15-16 (Mar. 26, 2012) [hereinafter FTC Privacy Report], https://www.ftc.gov/sites/default/files/documents/reports/federal-trade-commission-report-protecting-consumer-privacy-era-rapid-change-recommendations/120326privacyreport.pdf.

3 *See generally* FTC Privacy Report, *supra* note 2, at 23-30, 60-70; *see also Enforcing Privacy Promises,* Fed. Trade Comm'n, https://www.ftc.gov/news-events/media-resources/protecting-consumer-privacy/enforcing-privacy-promises (last visited Aug. 31, 2016).

4 More than 84 percent of adult Americans use the internet today, with notable variations by age. For young adults, the figure is 96 percent. Andrew Perrin & Maeve Duggan, *Americans' Internet Access: 2000-2015*, Pew Research Ctr. (June 26, 2016), http://www.pewinternet.org/2015/06/26/americans-internet-access-2000-2015.

its jurisdiction (i.e., traditional voice telephony providers)[5] until recently it lacked the legal authority to impose such rules on broadband providers. That changed in February 2015, when the FCC reversed course on its underlying legal approach to regulating ISPs by "reclassifying" broadband internet access service ("BIAS") as common carriage under Title II of the Communications Act.[6] Privacy considerations were not the driving factor behind the FCC's adoption of these "net neutrality" rules, but by virtue of an exemption for common carriers in the FTC's own governing statute,[7] the FCC's decision effectively stripped its sister agency of power to continue to police ISPs.

The FCC now is trying to fill the gap it created. Rather than build on the FTC's established foundation, however, the FCC appears determined to retrofit and expand its old rules for voice telephony[8] in a manner that likely will confuse or annoy consumers, while effectively discouraging broadband providers from offering new, competitive choices for online products and services. The FCC's proposals include a three-level consent regime, with requirements that turn on the identity of the online user of the information—i.e., whether the entity is the ISP, an affiliate, or a third party—rather than on how sensitive the information is, regardless of who may be using it. Required consent mechanisms also would vary based on whether the product or service being promoted fits into the vaguely defined (but apparently narrow) category of "communications-related services."[9] When in doubt, the proposed rules would require an ISP to seek affirmative "opt in" consent from consumers,[10] even when most consumers would not consider the data at issue—such as their online shopping interests—to be particularly sensitive.

As a result, the FCC proposal would require ISPs and their affiliates to pepper consumers with frequent opt-in consent requests covering all sorts of data, whether sensitive or not. Edge providers, on the other hand, need only abide by the FTC's more flexible approach—which calls for opt-in consent simply when the information concerns facts that most consumers would consider sensitive and therefore in need of additional safeguards. Thus, two different online entities might seek to market the exact same product or service to consumers, but be faced with decidedly different privacy mandates. On the broadband provider side, the proposed FCC rules would impose additional costs on both consumers (in terms of time) and broadband providers (in terms of time and resources), for no obvious beneficial purpose. Consumers also may detect the differences as they comparison shop across websites and wonder why the processes are so uneven.

It should not have to be this complicated. Consumers should be able to protect their sensitive information from online disclosures without being inundated by frequent requests for sharing data that most people do not consider sacrosanct. Consumers should not be forced to guess whether an entity holding and using their data is an ISP's affiliate, or how closely related the entity's product or service is to the ISP's service, in order to understand how to make choices about the collection, use, and sharing of their private information.[11] And ISPs should be able to compete on a level regulatory playing field in offering innovative products and services against rivals (in many cases much larger and more ubiquitous entities) that still will be governed by the FTC's consumer-centric approach to privacy regulation.

The discussion below provides background on the legal and policy considerations underlying the *Privacy Notice*, followed by details on certain rule proposals—the asymmetric burdens ISPs would shoulder generally, the complex construct for obtaining consumer consent, and the FCC's skepticism about customer discount programs—and how they differ from the FTC's approach.[12] The analysis ends with a review of constitutional objections also raised against the FCC's proposal.

I. Background: Two Commissions Develop Distinctly Different Approaches to Consumer Privacy

The disconnect between the FCC and the FTC on broadband privacy is rooted partly in the two agencies' different approaches to regulation generally. The FCC has broad rulemaking authority over the relatively narrow "communications" sector of the U.S. economy, and for decades it has proposed and adopted new rules—often very detailed ones—for the entities under its jurisdiction. While this rules-based approach arguably may help regulated entities by establishing bright-line directives, it is not well suited to parts of the communications sector undergoing rapid technological change. Adopting a new set of substantial rules usually takes years; the time frame often includes court challenges and remands back to the FCC that require another round of notice-and-comment rulemaking.[13] The result too often has been prescriptive regulations tailored to the technology in place at the time of the rules' adoption, but which may become increasingly out of date (and even nonsensical) as new technological breakthroughs supplant old hardware and software.[14]

5 *See* Telecommunications Act of 1996, 47 U.S.C. § 151 *et seq.* (1996) [hereinafter 1996 Act], https://transition.fcc.gov/Reports/1934new.pdf; 47 U.S.C. § 222 (common carrier privacy requirements).

6 *Protecting and Promoting the Open Internet*, Report & Order, 30 FCC Rcd 5601 (2015) [hereinafter *Open Internet Order*], https://apps.fcc.gov/edocs_public/attachmatch/FCC-15-24A1_Rcd.pdf.

7 Federal Trade Commission Act, 15 U.S.C. § 45(a)(2) [hereinafter FTC Act].

8 *Privacy Notice*, *supra* note 1, ¶ 302.

9 *Id.* ¶¶ 71-73.

10 *Id.* ¶¶ 139-142.

11 At different points the *Privacy Notice* focuses on one or more of the three activities—data collection by the ISP, internal use of the data by the ISP, and sharing of the data with third parties. For simplicity's sake, this overview employs the term "use" broadly to refer to all three activities.

12 The *Privacy Notice* calls for comment on several other significant issues that are not addressed here, including the timing and wording of ISP messages seeking consumer consent; data security requirements; breach notification mandates; and the use of disaggregated, anonymous consumer data as a privacy-protection mechanism.

13 One illustration of this process is the FCC's history of attempting to update its broadcast ownership rules, which over five cycles of rulemaking and court remand over two decades has resulted in little change. *See, e.g.*, Prometheus Radio Project v. FCC, 824 F.3d 33 (2016) (referencing vacating the new FCC media ownership rules).

14 For example, the FCC's effort to implement a provision of the Telecommunications Act of 1996 calling for "competitive availability" of "navigation devices" used with cable services, 47 U.S.C. § 76.640(a)-(b), triggered years of regulatory and engineering efforts to develop the

In contrast, the FTC has relatively little notice-and-comment rulemaking authority. Instead, it largely proceeds by pursuing enforcement actions against specific companies under Section 5 of the Federal Trade Commission Act, which broadly empowers the FTC to police "unfair or deceptive acts or practices."[15] With respect to consumer privacy cases, the FTC typically deems misleading privacy policies or practices to be "deceptive" while unreasonable data security safeguards are treated as "unfair."[16] Over time, the agency has developed three core principles—transparency, consumer choice, and data security—to guide its privacy enforcement actions.[17]

The FTC has brought more than 500 privacy and data security cases to date, covering both online and offline information.[18] Companies now operating under FTC enforcement orders include online giants such as Facebook, Google, Twitter, and Snapchat.[19] The FTC also has considered whether ISPs are so distinct from other "large platform providers" that special, more stringent regulations should apply. The general answer was determined to be "no": "[A]ny privacy framework should be technology neutral. ISPs are just one type of large platform provider that may have access to all or nearly all of a consumer's online activity."[20]

Developing regulation through case precedent may not provide immediate, bright-line guidance to regulated entities, but it does allow for flexible and relatively quick adaptation of settled principles to new situations, including changes over time in technology and consumer use. As FTC Commissioner Maureen Ohlhausen has explained, her agency's case-by-case application of its principles "has major advantages over a prescriptive rulemaking approach. The FTC's approach minimizes the regulator's knowledge problem, fosters incrementalism, and focuses limited resources on addressing consumer harm. These advantages are particularly beneficial in fast-changing areas such as privacy and data security."[21]

The FTC also provides guidance by developing issue-specific reports and other educational tools, which often draw on input from interested businesses, consumers, and academics. For online privacy purposes, the FTC's 2012 report *Protecting Consumer Privacy in an Era of Rapid Change* ("*FTC Privacy Report*") has been seminal. Consistent with FTC case law, the *FTC Privacy Report* distinguishes between (1) personal data collected and used "consistent with the context of the transaction or the company's relationship with the consumer," for which express consent is not needed; and (2) collecting sensitive data or using consumer data "in a materially different manner than claimed when the data was collected," for which affirmative consent is required.[22] The FTC approach encourages online entities to provide "opt out" options to consumers who may prefer to restrict the use and sharing of personal information—a construct that studies show leads to more sharing of non-sensitive information, such as buying habits, than does the more restrictive "opt in" alternative.[23]

Section 5 reins in the FTC's broad authority in a few specific business arenas, however, and common carriage is one of them.[24] Until 2015, that exemption was not much of a limitation with respect to broadband privacy because the FCC—in a series of pronouncements and decisions between 1998 and 2008—determined that BIAS was not common carriage.[25] Instead, the

"CableCARD" rules, § 76.1205(b)-(c), 1602(b). Those rules supported technology that could separate content security from set-top boxes, which then could be independently developed and sold in retail stores. By the time the analog-based technology reached the marketplace, however, cable operators were upgrading their systems to digital technology, which is not compatible with CableCARDs. *See* FCC Public Notice, Comment Sought on Video Device Navigation (Dec. 3, 2009) ("The Commission's CableCARD rules have resulted in limited success in developing a retail market for navigation devices.").

15 FTC Act, *supra* note 7, § 45(a)(1).

16 *See, e.g.*, FTC, Commission Statement Marking the FTC's 50th Data Security Settlement at 1 (Jan. 31, 2014), https://www.ftc.gov/system/files/documents/cases/140131gmrstatement.pdf.

17 *See* Comments of the Staff of the Bureau of Consumer Protection of the FTC, Protecting the Privacy of Customers of Broadband and Other Telecommunications Services, WC Docket No. 16-106, 6 (filed Feb. 23, 2016) [hereinafter FTC Staff Comments], https://ecfsapi.fcc.gov/file/60002078443.pdf.

18 *Id.* at 4 and n.11, *citing* Letter from Edith Ramirez, Chairwoman, FTC, to Věra Jourová, Comm'r for Justice, Consumers & Gender Equality, Eur. Comm'n at 3 (Feb. 23, 2016), https://www.ftc.gov/public-statements/2016/02/letter-chairwoman-edith-ramirez-vera-jourova-commissioner-justice.

19 *See, e.g.*, *Snapchat, Inc.*, FTC File No. 132-3078, Docket No. C-4501 (2014); *see generally Privacy and Security Cases*, Fed.Trade Comm'n, https://www.ftc.gov/datasecurity (last visited Aug. 31, 2016).

20 FTC Privacy Report, *supra* note 3, at 56; *see also* J. Howard Beales & Jeffrey A. Eisenbach, Putting Consumers First: A Functionality-Based Approach to Online Privacy (Jan. 1, 2013), http://ssrn.com/abstract=2211540 (arguing that attempts to impose an asymmetric privacy regulations targeted at particular technologies, business models or types of firms would be counterproductive); *see also* Big Data: A Tool for Inclusion or Exclusion?, Fed. Trade Comm'n (Jan. 2016) [hereinafter FTC Big Data], https://www.ftc.gov/system/files/documents/reports/big-data-tool-inclusion-or-exclusion-understanding-issues/160106big-data-rpt.pdf (focusing on how commercial use of big data from consumer information can impact low-income and underserved populations).

21 Comment of Comm'r Maureen K. Ohlhausen, Fed. Trade Comm'n, WC Docket No. 16-106 at note 4 (filed May 27, 2016) [hereinafter Ohlhausen Statement], https://ecfsapi.fcc.gov/file/60002079250.pdf.

22 FTC Privacy Report, *supra* note 2, at vii-viii.

23 *See* Mindi Chahal, *Consumers less likely to 'opt in' to marketing than to 'opt out'*, Marketing Week, May 7, 2014, https://www.marketingweek.com/2014/05/07/consumers-less-likely-to-opt-in-to-marketing-than-to-opt-out/ (study found that 29 percent of respondents would opt-in compared to 51 percent who would not opt-out); Eric J. Johnson, et. al., Defaults, Framing and Privacy: *Why Opting In-Opting Out*, 13 Marketing Letters 5, 7-9 (2002), https://www0.gsb.columbia.edu/mygsb/faculty/research/pubfiles/1173/defaults_framing_and_privacy.pdf. (finding that opt-out choices led to participation by up to twice as many people as opt-in choices).

24 The exemption dates back to the FTC Act's 1914 beginnings. *See* T.C. Hurst & Son v. FTC, 268 F. 874 (E.D. Va. 1920).

25 The FCC's analysis of the issue began with a 1998 report to lawmakers, *Federal-State Joint Board on Universal Service, Report to Congress*, CC Docket No. 96-45, 13 FCC Rcd 11501 (1998), and consistently reached the same conclusion in platform-by-platform classification decisions. *See, e.g.,* High-Speed Access to the Internet over Cable and Other Facilities, 17 F.C.C.R. 4798, 4802 (2002), *aff'd* Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967 (2005).

FCC decided, it was best "classified" as a lightly regulated, non-common carriage offering under Title I of the Communications Act, which contains few explicit regulatory mandates. Because ISPs face competition from rivals (including cable operators, wireless providers, and wireline telephony networks), the FCC concluded that market forces would deliver consumer benefits in the form of service options and fair prices without the need for heavy-handed rules.

Then the FCC changed its mind.[26] The sharpest dispute in the FCC net neutrality rulemaking concerned the reclassification decision, which determined the legal foundation on which the new rules rest. Common carriage status under Title II comes with scores of obligations and mandates.[27] In reclassifying broadband service, the FCC used its "forbearance" authority to avoid imposing many common-carriage rules on ISPs.[28] But the FCC did apply the Title II privacy provision, Section 222 of the Communications Act, to broadband providers.

Section 222 has given the FCC has some limited experience over the last two decades with privacy regulation of traditional voice telephony providers. In 1996, Congress directed the FCC to regulate a certain type of common carriage data: the "customer proprietary network information" ("CPNI") collected in connection with the provision of "telecommunications service" such as traditional voice telephony. The statute defines CPNI as "information that relates to the quantity, technical configuration, type, destination, location, and amount of use of a telecommunications service … and that is made available to the carrier by the customer solely by virtue of the carrier-customer relationship."[29] CPNI originally was understood to mean data such as customer calling patterns, payment history, and other information derived from a customer's actual use of the voice telephony service, but not more general personal information such as a customer's name and phone number, which often is publicly available from other sources.[30] Section 222 also allows common carriers to use, disclose, or share "aggregate" CPNI (i.e., collective data reflecting patterns of use among large numbers of unidentified customers) for any purpose.[31] Such generalized data has been critical for many benign purposes, such as routine traffic management and long-range network expansion planning.[32]

Until it issued the *Privacy Notice*, the FCC had never indicated that it would revamp its Section 222 rules to expand the provision's reach well beyond CPNI to include a potentially boundless set of "personally identifiable information."[33] Most observers expected the FCC to extend its Section 222 authority to broadband providers in the wake of the net neutrality decision, but many also hoped that the agency would craft regulations patterned on the FTC's approach. That hope seemed reasonable; FCC Chairman Tom Wheeler had repeatedly praised the FTC's privacy efforts through the first quarter of 2016. In January 2016, he said, "[w]hat the FTC has done in that regard is to build a terrific model and so I think one of our challenges is to make sure we're consistent with the kind of thoughtful, rational approach that the FTC has taken."[34] Just days before the FCC's March adoption of the *Privacy Notice*, Chairman Wheeler told reporters that "[w]e're following the same kind of conceptual framework that the FTC has."[35]

But that does not appear to be the way that the FCC's broadband privacy proposal turned out, and even the FTC staff experts on consumer privacy have (politely) said as much.

II. The FCC's Broadband Privacy Rule Proposals—And What the FTC Thinks of Them

Among the more than 250,000 submissions in the broadband privacy rulemaking, two filings stand out: the comments of the FTC's Bureau of Consumer Protection ("FTC Staff Comments") and a related statement from FTC Commissioner Ohlhausen.[36] These submissions are not unprecedented; the views of both the FTC and the U.S. Department of Justice's Antitrust Division occasionally have popped up in various FCC dockets. But the two FTC filings in the broadband privacy proceeding are noteworthy for how often they respectfully disagree with the FCC's rule proposals and underlying assumptions. Below is an overview of several key issues on which the agencies appear to be split.

26 Despite general agreement on light-touch regulation for the internet, a majority of FCC commissioners still wished to impose enforceable regulations on broadband internet access, which led to a series of court losses for the agency. *See* Formal Complaint of Free Press and Public Knowledge Against Comcast Corp. for Secretly Degrading Peer-to-Peer Applications, 23 FCC Rcd. 13,028 (2008), *vacated*, Comcast Corp. v. FCC, 600 F.3d 642, 644 (D.C. Cir. 2010); Preserving the Open Internet, Report & Order, 25 FCC Rcd. 17,905 (2010), *vacated in part*, Verizon v. FCC, 740 F.3d 623 (D.C. Cir. 2014) (certain rules unlawfully imposed common-carrier duties without invoking Title II).

27 There are several ongoing court challenges to the reclassification. *See, e.g.*, Joint Pet'n for Reh'g En Banc, U.S. Telecom Assoc. v. FCC, No. 15-1063 (D.C. Ct. App. July 29, 2016).

28 *Open Internet Order*, *supra* note 6, ¶¶ 493-527.

29 47 U.S.C. § 222(h)(1)(A).

30 Beginning in 2014, however, the FCC's Enforcement Bureau has been interpreting other provisions in Section 222 to broadly encompass additional "private information that customers have an interest in protecting from public exposure," including "personally identifiable information" ("PII"). *See, e.g.*, Terracom, Inc., & Yourtel Am., Inc., Order & Consent Decree, 30 FCC Rcd. 7075 (E.B. 2015).

31 47 U.S.C. § 222(c)(3).

32 As a result, a number of carriers argued both at the FCC and on Capitol Hill that data that can be helpful for network diagnostic purposes should not be deemed "CPNI" under Section 222. *See, e.g.*, Letter from Timothy P. McKone, Exec. Vice Pres., Fed. Relations, AT&T, Inc., to Sen. Al Franken (D-Minn.) at 1 (Dec. 14, 2011) (AT&T uses Carrier IQ "to collect diagnostic information about its network.").

33 *See* EPIC Customer Proprietary Network Information (CPNI), Order, 22 FCC Rcd 6927 (2007) (requiring requires each carrier to certify compliance with the regulations governing customer information).

34 Margaret Harding McGill, FCC, *FTC Chiefs Zero In On Data Security, Privacy*, Law360 (Jan. 6, 2016), http://www.law360.com/articles/743314/fcc-ftc-chiefs-zero-in-on-data-security-privacy.

35 Kate Tummarello & Alex Byers, *Wheeler's crystal ball: Net neutrality decision soon*, Politico (Mar. 17, 2016), http://www.politico.com/tipsheets/morning-tech/2016/03/wheelers-crystal-ball-net-neutrality-decision-soon-garland-a-quick-study-on-telecom-issues-a-path-forward-for-small-biz-bill-in-the-senate-213269.

36 Ohlhausen Statement, *supra* note 21, at 2-4.

A. Are Broadband Providers So Different From Other Online Entities That Heavier Regulation Is Needed?

- FCC: ISPs have unique access to consumer data and so warrant more regulation.
- FTC: No, ISPs are like other big players in the online arena, and privacy regulation should be technology neutral.

From the outset, the FCC's *Privacy Notice* justifies its elaborate rule proposals by contending that ISPs are uniquely positioned to develop highly detailed, comprehensive profiles of their customers. The FCC contends that, absent the use of encryption, "last mile" broadband networks have the ubiquitous ability to monitor traffic transmitted between the consumer and each online destination, including the ability to review the content being accessed or exchanged.[37] According to the FCC, even when traffic is encrypted, the broadband provider can determine which websites a customer has visited, for how long, and during what hours of the day, among other information.[38] Thus, the FCC concludes, ISPs capture a breadth of data that edge providers do not. The FCC also claims that once a broadband consumer signs up for an ISP's service, the consumer simply cannot avoid that network—or easily switch—as he or she could for a search engine or some other edge provider service.[39]

As noted above, the FTC disagrees, at least with respect to the FCC's assertion that ISPs have a uniquely comprehensive view of consumers' online activity. The FTC characterizes ISPs as "just one type of large platform provider that may have access to all or nearly all of a consumer's online activity."[40] At a privacy workshop the FTC held in 2012, the Associate Director of the agency's Privacy Division stated that "there are lots of business models . . . that can permit an entity to get a pretty comprehensive window into consumers' browsing behavior."[41] The FTC has repeatedly stressed the value of a technology-neutral approach to privacy regulation in order to ensure that the government does not "pick[ ] winners and losers" in the online marketplace.[42]

The FTC Staff Comments warned that "the FCC's proposed rules, if implemented, would impose a number of specific requirements on the provision of [broadband] services that would not generally apply to other services that collect and use significant amounts of consumer data. This outcome is not optimal."[43] The FTC has called for broad-based privacy laws applicable to all companies, but until Congress passes such legislation, the FTC Staff Comments gently suggest, federal agencies should harmonize their privacy protection efforts as much as possible.[44]

The two agencies' disagreement about ISPs' technological advantages echoes a split among the private commenters—including public interest groups, associations, and broadband providers—as to whether the purported advantages are real. Several public interest groups, including some allied with edge providers that would not be subject to onerous FCC rules, agree with the FCC's interpretation.[45] Broadband providers and others, including the former head of the FTC's Bureau of Consumer Protection, strongly disagree.[46] Many in the latter group cite to an analysis developed by Georgia Tech's Institute for Information Security and Privacy, which finds that, due to a combination of factors, any given ISP's view of subscriber data is limited, not comprehensive, and is becoming narrower. These factors include a typical consumer's use of multiple devices to access the internet using different ISPs, pervasive encryption of websites, and growing use of proxy services such as virtual private networks ("VPNs")—all of which inhibit any single ISP from being able to track and collect data about subscribers' online activities.

The importance of this issue is hard to overstate: Either ISPs have an advantage in collecting and using consumers' personal data or they do not. If they do not, asymmetric regulation of them is unjustified, and could harm consumers in several ways. Beyond simply confusing or annoying them with elaborate consent mechanisms, the FCC's approach could hurt consumers by effectively blocking the delivery of some targeted advertising that they may want and find useful—although plenty of targeted advertising delivered by edge providers would remain unfettered. The FCC's proposals also may impede competition by dissuading or preventing ISPs from offering new and innovative services, such as home alarm systems, online entertainment platforms, and health-monitoring services, to rival those offered by edge providers.

B. Is a Detailed, Multi-Layered Consent Regime Based on the Identity of the Broadband Entity Necessary?

- FCC: A consent regime based on the data user's identity will help consumers.
- FTC: No, distinctions should turn on the sensitivity of the data, not the entity using it.

The FCC's concept for how broadband providers should obtain consumer consent to use personal information may be the most challenging aspect of the rulemaking—at least for those who are not steeped in FCC regulation. The FCC admits that it drew on its decades-old voice telephony rules in creating the concept, even though the old rules covered considerably less

37 *Privacy Notice*, *supra* note 1, ¶ 4.

38 *Id.* ¶ 4.

39 *Id.*

40 FTC Privacy Report, *supra* note 2, at 56.

41 *See* Transcript of Fed. Trade Comm'n Workshop, The Big Picture: Comprehensive Online Data Collection at 272 (Dec. 6, 2012), https://www.ftc.gov/sites/default/files/documents/public_events/The%20Big%20Picture%3A%20Comprehensive%20Online%20Data%20Collection/bigpicture_transcript_21206ftc.pdf.

42 *Id. See also* FTC Privacy Report, *supra* note 2, at 11.

43 FTC Staff Comments, *supra* note 17, at 8.

44 *Id.* at 8.

45 *See, e.g.*, Comments of Pub. Knowledge, Benton Found., Consumer Action, Consumer Fed'n of Am. & Nat'l Consumers League, WC Docket No. 16-106 (filed May 27, 2016) [hereinafter Public Knowledge Comments], https://ecfsapi.fcc.gov/file/60002080037.pdf.

46 *See* Comments of J. Howard Beales, Prof. of Strategic Mgmt. & Pub. Pol'y, George Washington Sch. of Business, WC Docket No. 16-106 (filed May 27, 2016), https://ecfsapi.fcc.gov/file/60002077356.pdf.

data and were designed to serve narrower purposes.[47] Instead of starting anew by thinking about the consumer's perspective, the FCC proposes different types of consent mechanisms that turn on the identity of the information gatherer/user, not on the sensitivity of the consumer's data. For consent mechanism purposes, it also matters whether the ISP's (or its affiliate's) use of the data is closely "related" to the ISP's "communications services" or not.[48] How a consumer is supposed to grasp any of this is unclear; even broadband providers could struggle with the distinctions.

Specifically, the FCC would divide an ISP's uses of consumer data into three categories, with different consent mechanisms applicable to each:

(1) *Consumer consent will be implied* when the ISP simply uses consumer information, such as an email address or device identifier, in the course of providing the broadband service that the consumer has requested.[49] This would cover a very narrow category of uses, and the implied consent approach is not controversial.

(2) *Consumers must be allowed to opt out* of use their data if the ISP or its affiliate employs the information to market "communications-related services."[50] This is a slightly broader category, but perhaps not by much; the *Privacy Notice* does not define the key term other than to disfavor the broader meaning of "communications-related services" still used in the old voice telephony rules. That broader definition encompassed "information services," the forerunner of today's broadband service.

(3) *Consumers must affirmatively opt in* to consent to a broadband provider's use of personal data for any other purpose—including the sharing of consumer data with any third parties, such as advertisers or partners in marketing goods or services, whether they are communications-related or not. In the real world, this will be the broadest category of all. It will impose extra steps on consumers even when it is not warranted, as would be the case for benign uses such as targeted advertising, which is based on data many consumers do not consider sensitive (and which they will continue to receive from other online entities not subject to FCC rules). And it is likely to impede broadband providers' ability to compete with edge providers in offering such goods and services: Studies show that consumers tend to share less information under an opt-in regime than under on opt-out one, even when the personal data at issue is the same.[51]

The FTC Staff Comments suggest that consumers will not find the FCC's proposed consent regime helpful.[52] To the FTC, the focus should be on the consumer's expectations in light of the consumer's interaction with the company, whatever it may be, and on the reasonableness of those expectations, which likely will turn on the sensitivity of the particular data at issue.[53] Under this light, the FTC staff said, some elements of the FCC's consent scheme—such as implied consent to the use of personal data in the context of the actual provision of broadband service—make sense."[54]

But the FTC staff questioned other elements of the FCC's proposal. With respect to distinguishing between an ISP's affiliate and a third party, the FTC staff pointed out that consumers may find it difficult to differentiate between the two, especially if the affiliate's name offers no hint of a corporate connection to the consumer's ISP.[55] Absent an understanding of the regulations, consumers could be left wondering why some websites or online services pepper them with privacy consent requests while other comparable sites and services do not—a difference that might steer a consumer away from the ones that pester them.

More generally, the FTC staff observed, the FCC's proposed approach:

> does not reflect the different expectations and concerns that consumers have for sensitive and non-sensitive data. As a result, it could hamper beneficial uses of data that consumers may prefer, while failing to protect against practices that are more likely to be unwanted and potentially harmful. For example, consumers may prefer to hear about new innovative products offered by their BIAS providers, but may expect protection against having their sensitive information used for this or any other purpose.[56]

FTC Commissioner Ohlhausen reiterated that point in her assessment: "The FCC's three-tiered "implied consent/opt-out/opt-in" framework . . . does not account for the sensitivity of the consumer data involved. Thus, the FCC would require opt-in consent for many uses of non-sensitive consumer data by BIAS providers, yet would require no consent at all for certain uses of sensitive data by those providers"[57]

In other words, context counts, and rigid rules that repeat old regulatory distinctions, rather than provide scope to assess a consumer's reasonable expectations in the circumstances, will not serve consumers well.

C. Should Consumers Be Required to Consent in Advance to Almost Any Use of Their Data, Even When the Information Is Not Sensitive?

- FCC: Requiring affirmative opt-in consent as the general rule helps consumers.
- FTC: No, repetitive and unnecessary consent requests may be counterproductive.

The FCC's preference for opt-in consent in almost all circumstances is at odds with the FTC's approach, both the FTC

47 *See Privacy Notice*, *supra* note 1, ¶¶ 6-7, 11-13.

48 *Id.* ¶ 107; Peter Swire et al., *Online Privacy and ISPs: ISP Access to Consumer Data is Limited and Often Less than Access by Others* (Inst. for Info. Sec'y & Privacy at Georgia Tech., Working Paper, Feb. 29, 2016), http://www.iisp.gatech.edu/sites/default/files/images/online_privacy_and_isps.pdf.

49 *Privacy Notice*, *supra* note 1, ¶¶ 112-21.

50 *Id.* ¶ 122.

51 *See supra* note 23; *see also* Thomas M. Lenard & Paul H. Rubin, *In Defense of Data: Information and the Costs of Privacy*, Technology Policy Institute, 46 (May 2009) ("[C]onsumers have a tendency not to change the default, whatever it might be.").

52 FTC Staff Comments, *supra* note 17, at 22.

53 *Id.* at 19.

54 *Id.* at 16.

55 *Id.* at 23-24.

56 *Id.* at 22-23.

57 Ohlhausen Statement, *supra* note 21, at 2.

Staff Comments and Commissioner Ohlhausen explained. The FTC staff suggested that the FCC reserve opt-in requirements for a narrow universe of sensitive information that could be collected by broadband providers, including: (1) the actual content of communications, and (2) Social Security numbers or health, financial, children's, or precise geolocation data.[58]

Commissioner Ohlhausen discussed the issue, including the FTC's preference for opt-out consent, at more length. The FTC approach also hews closely to context, Ohlhausen stated, "reflecting the fact that consumer privacy preferences differ greatly depending on the type of data and its use."[59] While consumer preferences are "fairly uniform" with regard to strong protections for sensitive data such as personal financial or medical information, the FTC "know[s] from experience as well as academic research—including a recent Pew study—that for uses of non-sensitive data, people have widely varying privacy preferences."[60]

In addition, the FCC should consider the burdens of exercising and obtaining consent for both consumers and businesses, Ohlhausen said:

> Reading a notice and making a decision takes time that, in the aggregate, can be quite substantial. Regulations should impose such costs in a way that maximizes the benefits while minimizing the costs. Therefore, opt-in or opt-out defaults should match typical consumer preferences, which mean they impose the time and effort of making an active decision on those who value the choice most highly. For advertising based on non-sensitive information, this generally means an opt-out approach. For uses of sensitive information, this generally means an opt-in choice.[61]

Imposing unnecessary burdens on consumers by requiring opt-in consent in almost every instance, even for data considered non-sensitive by many people, carries consequences beyond annoying individuals, Ohlhausen stated. She noted that the cumulative effect of the "burdens imposed by a broad opt-in requirement may also have negative effects on innovation and growth," citing a recent Report of the President's Council of Advisors on Science and Technology as support.[62]

In short, a consent requirement that overburdens consumers has real costs. Besides wasting what can add up to a lot of time in the aggregate, bombarding consent requests may even tend to make consumers numb to requests that they should consider carefully, such as those involving truly sensitive data. The FCC proposal's failure to account for consumer preferences and the way that consumers today generally expect the internet to operate could be counter-productive, producing exactly the opposite result of the FCC's privacy-protection goal.

D. Should Broadband Providers Be Barred From Offering Discounts to Subscribers Who Agree to the Use and Sharing of Some of Their Personal Data?

- FCC: Prohibiting ISPs from offering "financial inducements" in exchange for consent to use of personal data may protect consumers.
- FTC: No, consumers informed about their choices should be free to opt for discount programs because they can cut costs.

The *Privacy Notice* raises questions about controversial discount programs in which an ISP offers lower priced broadband subscriptions in exchange for consumer consent to its use of some personal data, such as shopping and purchasing habits. The disagreement over these programs centers on whether such discounts could take advantage of low-income consumers who might not "generally understand that they are exchanging their information as part of those bargains."[63] Although the FCC dubbed such programs "financial inducement practices," the agency also acknowledged that "it is not unusual for consumers to receive perks in exchange for use of their personal information" in both "the bricks-and-mortar world" of consumer loyalty programs and in the broadband arena where "'free' services in exchange for information are common."[64] The FCC asked in the rulemaking whether it should prohibit financial inducement practices and, if not, what steps it should take to ensure that consumers understand the trade-offs and can change their minds later.

FTC Commissioner Ohlhausen criticized the *Privacy Notice*'s framing of the issue, beginning with the FCC's "mischaracterize[ation]" of the FTC's own 2016 Big Data Report discussion of the topic.[65] She urged the FCC not to flatly ban

58 FTC Staff Comments, *supra* note 17, at 20.

59 Ohlhausen Statement, *supra* note 21, at 2.

60 *Id.*, *citing* Lee Rainie & Maeve Duggan, *Privacy And Information Sharing*, Pew Research Ctr. (Dec. 2015), http://www.pewinternet.org/2016/01/14/privacy-andinformation-sharing.

61 Ohlhausen Statement, *supra* note 21, at 2. She cited former FTC officials who made the same point eight years ago:

> Customers rationally avoid investing in information necessary to make certain decisions . . . when their decision is very unlikely to have a significant impact on them. . . . Default rules should be designed to impose those costs on consumers who think they are worth paying. An opt-out default rule means that consumers who do not think that decision making costs are worthwhile do not need to bear those costs. Consumers who care intensely, however, will face the costs of making a decision.

J. Howard Beales, III & Timothy J. Muris, *Choice or Consequences: Protecting Privacy in Commercial Information*, 75 U. Chi. L. Rev. 109, 115 n. 20 (2008).

62 Ohlhausen Statement, *supra* note 21, at 3, *citing* President's Council of Advisors on Science and Technology, Report to the President: Big Data And Privacy: A Technological Perspective x-xi (May 2014) ("[A] policy focus on limiting data collection will not be a broadly applicable or scalable strategy – nor one likely to achieve the right balance between beneficial results and unintended negative consequences (such as inhibiting economic growth.")).

63 *Privacy Notice*, *supra* note 1, ¶ 260.

64 *Id.*

65 The FTC has not found broadband discount programs to be problematic, Ohlhausen said; the Big Data Report referred to qualms raised by some participants in FTC workshops, but noted that such programs "can create opportunities for low-income and underserved communities." Ohlhausen Statement, *supra* note 21, at 3, *citing* FTC Big Data, *supra* note 20.

"discounts for ad-supported BIAS" because that action would bar:

> a consumer from trading some of her data for a price discount, even if the consumer is fully informed. Would-be broadband subscribers cite high cost as more important than privacy concerns for the reason why they have not adopted broadband. Given that fact, such a ban may prohibit ad-supported broadband services and thereby eliminate a way to increase broadband adoption.[66]

If it does regulate broadband discount programs in some fashion, Ohlhausen stated, the FCC should at least take into account the FTC's views on the subject: In markets where consumers have choices among broadband providers and the terms of the discount program "are transparent and fairly disclosed . . . such choice options may result in lower prices or other consumer benefits, as companies develop new and competing ways of monetizing their business models."[67]

The discount program debate has been among the liveliest arguments in the FCC's rulemaking docket, with even public interest commenters split as to whether the offerings are beneficial or not.[68] The issue also has become a vehicle for re-arguing larger broadband policy disputes, including the competitiveness, or not, of the BIAS marketplace and incentives needed to drive greater broadband adoption and deployment.[69]

III. Constitutional Dimension: Asymmetric Restraints on Speech Raise Red Flags

Although the FTC staff and Commissioner Ohlhausen confined their input to policy issues, scores of other commenters raised serious legal arguments as well. Statutory authority contentions are front and center for most of them,[70] but another legal issue also is in play: the constitutional right of broadband providers to engage in commercial speech—a right that encompasses the effort to craft such messages for delivery. Somewhat surprisingly, the *Privacy Notice* pays little attention to the First Amendment implications of disproportionately burdening ISPs with broad opt-in consent mandates that would not apply to other entities that use non-sensitive consumer data to market comparable goods and services online. The FCC devotes just one oblique paragraph to the issue.[71]

This attempt to sidestep the First Amendment may reflect the FCC's understanding of the constitutional pitfalls. The FCC routinely confronts free speech challenges to its regulations, primarily in the media space but occasionally also in contexts such as common carriage.[72] The *Privacy Notice* does cite the *Central Hudson* test for evaluating commercial speech restrictions and ticks quickly through the three prongs of the test: (1) the speech restriction must serve a "substantial" government goal; (2) the restraint must "directly advance" that interest; and (3) the restriction must be "no[ ] more extensive than necessary to serve those interests."[73] Yet the FCC never actually applies the test to the facts at hand. The *Privacy Notice* simply asserts, with no evidentiary support, that its proposals—which would effectively restrict, and perhaps stymie, ISPs' use of non-sensitive consumer data to shape targeted advertisements—satisfy the First Amendment. In response, numerous commenters, including constitutional expert Laurence Tribe, point to constitutional infirmities in the proposed rules, including elements that may warrant a more exacting analysis than the "intermediate scrutiny" review accorded to commercial speech regulations.[74]

Even if the FCC's proposed rules were reviewed under intermediate scrutiny, they would be vulnerable. The preeminence of the FTC in the privacy field complicates the FCC's First Amendment position enormously. Government officials considering new speech restrictions rarely need to explain why their favored proposals are better than those of another agency. Even if the FCC's proposed rules could survive the first two prongs of *Central Hudson*, the FTC's privacy regulation will be a major obstacle at the end, because it provides a more tailored alternative for protecting consumer privacy that has been field-tested for years.

In fact, there are no sure wins for the FCC at any point in the *Central Hudson* analysis—and it would need to win on all of them. Regulators typically prevail on the first prong of the test,[75]

66 Ohlhausen Statement, *supra* note 21, at 3.

67 *Id.*

68 *Compare, e.g.*, Comments of Ctr. for Democracy & Tech., WC Docket No. 16-106 at 20-21 (filed May 27, 2016) [hereinafter Ctr. for Democracy & Tech. Comments] *with* Comments of MMTC, WC Docket No. 16-106 at 8 (filed May 27, 2016).

69 *See, e.g.*, Comments of the National Cable & Telecommunications Ass'n, WC Docket No. 16-106 at 13 (filed May 27, 2016) (ISP marketplace is competitive); Reply Comments of the Electronic Privacy Information Center, WC Docket No. 16-106 at 8 (filed July 6, 2016) (most sectors of online marketplace a monopoly or duopoly); Letter of American Association of People with Disabilities, WC Docket No. 16-106 at 1 (filed July 6, 2016) (expressing concern about effect of rule change on broadband adoption and deployment).

70 Critics of the FCC's proposals, including broadband providers large and small, contend that Section 222's telephony-oriented text does not support the sweeping new regulations that the FCC is considering, while supporters insist that the old language can stretch to encompass today's broadband services. *See, e.g.*, Comments of Free Press, WC Docket No. 16-106 at 8-13 (filed May 31, 2016) (supporting an expansive interpretation of Section 222); Ctr. for Democracy & Tech. Comments, *supra* note 68, at 11-12. Wireless broadband providers point to additional provisions of the Communications Act specific to them to bolster contentions that the proposed rules are legally unsound. *See, e.g.*, Comments of Verizon, WC Docket No. 16-106 at 16-28 (filed May 27, 2016); Comments of CTIA, WC Docket No. 16-106 at 44, 55-58 (filed May 26, 2016).

71 *Privacy Notice*, *supra* note 1, ¶ 302.

72 *See, e.g.,* Red Lion Broadcasting v. FCC, 395 U.S. 367 (1969) (spectrum scarcity justifies lower standard of First Amendment protection for broadcasters); Turner Broadcasting System, Inc. v. FCC, 520 U.S. 180 (1997) (upholding mandatory carriage of broadcast stations on cable systems); U.S. West Communications, Inc. v. FCC, 182 F.3d 1224 (10th Cir. 1999) (striking down restraints on analysis and sharing of CPNI among affiliates for use in crafting marketing messages).

73 *Privacy Notice*, *supra* note 1, ¶ 302, *citing* Central Hudson Gas & Elec. Corp. v. Pub. Serv. Comm'n of N.Y., 447 U.S. 557 (1980).

74 Letter of CTIA, *et al.*, WC Docket No. 16-106 (filed May 27, 2016) (submitting Laurence H. Tribe & Jonathan S. Massey, *The Federal Communications Commission's Proposed Broadband Privacy Rules Would Violate the First Amendment* at 23-24, 30-31 (dated May 27, 2016) (FCC proposals incorporate improper speaker- and content-based distinctions)).

75 *See, e.g.*, City of Cincinnati v. Discovery Network, Inc., 507 U.S. 410, 416 (1993).

and the FCC's generalized goal of protecting consumer privacy looks at first blush to be substantial enough. But the reach of the proposed definition for protected data is so expansive that it covers both sensitive material (e.g., information concerning personal finances, health, children, and geo-location) and non-sensitive information that many consumers do not consider confidential (e.g., shopping interests). The *Privacy Notice*'s relatively sparse discussion of concrete consumer concerns refers only to examples that most observers would agree involves *sensitive* data, such as geo-location data and financial data.[76] Moreover, the FCC recognizes that many consumers welcome online advertising targeted to their needs and interests.[77] Why, therefore, should the FCC seek to stringently protect consumers against targeted ads that draw upon non-sensitive data? Are such ads a real problem, much less a substantial one?

Moving to the next *Central Hudson* prong, how can the FCC's proposed restraint shield consumers from the alleged harm of the use of non-sensitive data for targeted advertising when they will continue to receive such data-driven ads from hundreds or thousands of edge providers not subject to FCC regulation? This issue—under-inclusiveness—is another weak point in the proposed regulatory scheme, for the FCC must demonstrate that the opt-in consent mandate would "directly advance" its goal.[78] Even if suppressing targeted advertising based on non-sensitive data were a valid objective, the proposed restrictions are not likely to slow or divert the overall flow of targeted online ads to consumers. The Supreme Court has repeatedly invalidated commercial speech restraints that constrain certain types or sources of speech while leaving others unaffected.[79] The FCC attempts to fend off this criticism by acknowledging that it cannot regulate edge providers' use of data,[80] but this is not a sufficient response—particularly given that the FCC plainly has another regulatory alternative available (i.e., the FTC approach).

The last prong of *Central Hudson* requires the FCC to demonstrate that that its proposed speech restraint is "narrowly tailored," meaning no more extensive than necessary to serve the purported goal.[81] The Supreme Court has explained that, while this prong does not require an agency to employ the least restrictive means possible to advance its objective, the agency still must show that it has considered alternatives before selecting one that "fits" the purpose while still being mindful of the speaker's—and the speech recipient's—constitutional rights.[82] The FCC's obstacle here is obvious: Adopting an opt-in consent mandate burdening the creation and delivery of nearly all targeted advertising by ISPs would require the agency to explain why adopting its own version of the FTC's more constitutionally sensitive approach would be insufficient. Because that approach has been employed for years and been well-accepted by consumers, the FCC would be hard-pressed to defend its more burdensome proposal as sufficiently tailored to serve a valid purpose.

The *Privacy Notice*'s cursory treatment of the commercial speech issues raises some red flags about the FCC's preference for opt-in consent in most circumstances; this means that the FCC's effort to distinguish ISPs from other online entities will be critically important to any future legal defense. As discussed above, the "uniqueness" of ISPs is in hot dispute, whether the claim concerns broadband providers' alleged ability to gather and use customer data or the purported lack of competition among ISPs. The FCC would have to prevail on at least one of these fundamental premises to avoid a serious risk of First Amendment challenge.

IV. Conclusion

The FCC's *Privacy Notice* proposes overly elaborate privacy rules for broadband providers that are likely to confuse consumers, dampen competition for innovative new services, and run afoul of First Amendment constraints. It is not too late for the FCC to pull back from its original proposals and fashion regulations consistent with the FTC's established approach. The latter applies a limited number of privacy principals—transparency, consumer choice, and data security—on a case-by-case basis, along with an appreciation of personal information generally understood to be sensitive, which should be subject to more protective measures than non-sensitive information. That approach also allows that agency to more quickly adapt to changes in technology, as well as trends in consumer uses of technology, than does a detailed rules-based regulatory framework. The attributes of the FTC system for privacy protection serve consumer interests well, and they merit continuation under the FCC's new privacy watch.

76 *E.g.*, *Privacy Notice*, *supra* note 1, ¶¶ 12 (discussing geo-location data), 20-21 (discussing whether Social Security numbers and financial account information should be subject to heightened protection).

77 *Id.* ¶ 12.

78 *See, e.g.*, Greater New Orleans Broadcasting Association, Inc. v. United States, 527 U.S. 173, 188-90 (1999).

79 *See, e.g.*, *Discovery Network*, 507 U.S. at 418-20; *Greater New Orleans*, 527 U.S. at 190, 194-95.

80 *Privacy Notice*, *supra* note 1, ¶ 132.

81 Board of Trustees of the State University of New York v. Fox, 492 U.S. 469, 479-80 (1989).

82 *See id.*

Book Review

The War on Cops: How the New Attack on Law and Order Makes Everyone Less Safe, by Heather Mac Donald

Reviewed by John G. Malcolm

Note from the Editor:

This book review supports the basic contentions of Heather Mac Donald's controversial book about crime and policing, while criticizing its tone and some of its assumptions.

The Federalist Society takes no positions on particular legal and public policy matters. Any expressions of opinion are those of the author. Whenever we publish an article that advocates for a position, as here, we offer links to other perspectives on the issue, including ones opposed to the position taken in the article.

Because this book and the review are about a controversial topic that divides, not only left and right, but even many on the right, we want to urge readers to send responses to this review. We will publish any particularly thoughtful and well-written responses. To join the debate, please email us at info@fedsoc.org.

• Heather Mac Donald, The War on Cops: How the New Attack on Law and Order Makes Everyone Less Safe (2016), *available at* https://www.amazon.com/War-Cops-Attack-Order-Everyone/dp/1594038759.

• Rachel Lu, *You Don't Have To Be Black Lives Matter To Support Police Accountability*, The Federalist (July 7, 2016), *available at* http://thefederalist.com/2016/07/07/you-dont-have-to-be-black-lives-matter-to-support-police-accountability/.

• Conor Friedersdorf, *'It's Time for Good Cops to Do Something About Bad Cops'*, The Atlantic (June 27, 2015), *available at* http://www.theatlantic.com/politics/archive/2015/06/its-time-for-good-cops-to-do-something-about-bad-cops/396890/.

• Max Ehrenfreund, *A new federal report discusses an unexpected theory for why murders are rising in U.S. cities*, Wash. Post Wonkblog (June 15, 2016), *available at* https://www.washingtonpost.com/news/wonk/wp/2016/06/15/the-unexpected-way-the-ferguson-effect-might-be-causing-more-murder/.

• Radley Balko, Wash. Post Blog, *available at* https://www.washingtonpost.com/people/radley-balko (opinion blog documenting criminal justice and police abuses).

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In *The War on Cops: How the New Attack on Law and Order Makes Everyone Less Safe*, Heather Mac Donald, a fellow at the Manhattan Institute, offers a scathing, data-driven account of the misguided and sometimes malicious attacks on the law enforcement community that are spreading like kudzu across the country—and of their consequences. Indeed, as I write this, reports out of San Diego of another officer being killed and another seriously wounded are flashing across the screen.[1] This kind of event has become all too commonplace. At the same time, rates of violent crime are creeping upwards in many of our largest cities after a decades-long decrease.

The public should be, but too often is not, horrified by spectacles such as Black Lives Matter (BLM) activists in St. Paul, Minnesota marching in the streets yelling, "Pigs in a blanket, fry 'em like bacon";[2] or BLM protestors in New York City chanting, "What do we want? Dead Cops! When do we want it? Now!";[3] or a message posted by the African American Defense League urging its followers to "hold a barbeque" and "sprinkle Pigs Blood!";[4] or the Facebook posting by a man in Detroit following the slaying of five Dallas police officers which read, "All lives can't matter until black lives matter. Kill all white cops."[5] One would think that, in any civilized society, such sentiments would be universally condemned as barbaric. Instead, such deplorable rhetoric is met with sympathy and tolerance by some on the Left.[6] One can acknowledge, as former Speaker of the House Newt Gingrich did recently, that "[i]f you are a normal white American, the truth

1 *Suspect arrested in shooting that killed San Diego police officer*, Fox News U.S., *available at* http://www.foxnews.com/us/2016/07/29/suspect-arrested-in-shooting-that-killed-san-diego-police-officer.html.

2 Chuck Ross, *Black Lives Matter Protestors Chant: 'Pigs In A Blanket, Fry 'Em Like Bacon,'* The Daily Caller (Aug. 29, 2015), *available at* http://dailycaller.com/2015/08/29/black-lives-matter-protesters-chant-pigs-in-a-blanket-fry-em-like-bacon-video/.

3 See video available at https://www.youtube.com/watch?v=Z_qkvXLuGsc.

4 Drew Griffin, David Fitzpatrick, and Curt Devine, *Was Dallas cop killer Micah Johnson radicalized online?*, CNN News (July 11, 2016), *available at* http://www.cnn.com/2016/07/10/us/micah-johnson-dallas-radicalized-online/.

5 George Hunter, *Detroit police arrest four for threats against cops*, The Detroit News (July 11, 2016), *available at* http://www.detroitnews.com/story/news/local/detroit-city/2016/07/11/detroit-police-arrest-four-threats-cops/86930930/.

6 *See, e.g.*, Asra Q. Nomani, *The Violent Tone of Black Lives Matter Has Alienated Even Liberals Like Me*, Heat Street (July 9, 2016), *available at* http://heatst.com/culture-wars/the-violent-tone-of-black-lives-matter-has-alienated-even-liberals-like-me/; James Barrett, *Black Lives Matter Sympathizers Respond to Dallas Attack by Trashing Cops*, The Daily Wire (July 8, 2016), *available at* http://www.dailywire.com/news/7303/black-lives-matter-activists-respond-dallas-attack-james-barrett; Barbara Reynolds, *I was a civil rights activist in the 1960s. But it's hard for me to get behind Black Lives Matter*, The Washington Post (Aug. 24, 2015), *available at* https://www.washingtonpost.com/posteverything/wp/2015/08/24/i-was-a-civil-rights-activist-in-the-1960s-but-its-hard-for-me-to-get-behind-black-lives-matter/?utm_term=.ae780d53d9fc.

is you don't understand being black in America and you instinctively under-estimate the level of discrimination and the level of additional risk." But one should also acknowledge, as Gingrich did, that, from the perspective of the police, "[e]very time you walk up to a car you could be killed. Every time you go into a building where there's a robbery you can be killed."[7] The hateful rhetoric quoted above only serves to incite violence, and, to put it mildly, generates more heat than light.

Yet some elected officials act more like rabble-rousing community organizers fanning the flames of racial tension, perhaps inadvertently, rather than acting like responsible public officials seeking to restore calm and respect for law and order.[8] Racial tensions in this country are clearly on the rise. A new Rasmussen poll indicates that 60% of likely voters think race relations have gotten worse since Barack Obama became president, up from 42% in late 2014,[9] and African Americans are far more likely to believe that they are treated unfairly by the police than whites.[10]

While, no doubt, there may be some police officers who harbor racist thoughts and tendencies—which is likely the case with every profession—that number is, I strongly suspect, very small and diminishing rapidly over time. And, of course, some police officers do engage in misconduct, occasionally with deadly consequences. Earlier this year, five New Orleans police officers pleaded guilty in connection with the killings that took place on Danziger Bridge in the aftermath of Hurricane Katrina (including one officer who pleaded guilty to covering up the misdeeds),[11] and video footage showed a South Carolina police officer shooting and killing a clearly unarmed man who was running away from him.[12] And many people (black and white) can recount stories in which they were treated rudely, perhaps unjustifiably so, by police officers. Do BLM protestors have a point? Yes, although their tactics and rhetoric are often inconducive to fostering improved relations between the police and the communities they serve. Clearly some police officers have reacted to tense situations with excessive force, most likely the result of inadequate training[13] rather than racism, which sometimes results in a tragic outcome. Of course, when police officers do use excessive force or commit an unjustified homicide, the matter should be investigated, with officers encouraged to come forward to say what happened, which may require something of a cultural change within the law enforcement community. And there should be consequences, up to and including criminal prosecution against those involved and those who attempt to cover up what happened, as happened recently in New Orleans and in New York City in the Abner Louima case.[14]

To hear some protestors, though, one would think that most police officers are card-carrying members of the Ku Klux Klan who run around indiscriminately shooting young black men. Indeed, every incident in which a black citizen is shot by a white police officer becomes part of the ongoing narrative of racist-cops-running-rampant, even when it is definitively established beyond peradventure that the shooting was justified, as was the case when Officer Darren Wilson shot Michael Brown in Ferguson, Missouri. Long after it was clear that Brown had attacked Wilson and was grabbing for his gun and that the whole "Hands up, don't shoot!" story was built on a pack of lies,[15] Officer Wilson was drummed out of the police force,[16] Jesse Jackson decried the fact

7 Eugene Scott, *Newt Gingrich: 'Normal white Americans … don't understand being black in America,'* CNN (July 8, 2016), *available at* http://www.cnn.com/2016/07/08/politics/newt-gingrich-white-americans/.

8 Liz Peek, *How Obama's Support of Black Lives Matter Deepens the Racial Divide*, The Fiscal Times (July 13, 2016), *available at* http://www.thefiscaltimes.com/Columns/2016/07/13/How-Obama-s-Support-Black-Lives-Matter-Deepens-Racial-Divide; Dave Boyer, *Obama defends Black Lives Matter protests at police memorial in Dallas*, Washington Times (July 12, 2016), *available at* http://www.washingtontimes.com/news/2016/jul/12/obama-defends-black-lives-matter-protests-police-m/; Justin Fenton, *State's Attorney Marilyn Mosby assails police, pledges to pursue reforms*, Baltimore Sun (July 27, 2016) (video starts automatically when page opens), *available at* http://www.baltimoresun.com/news/maryland/freddie-gray/bs-md-ci-mosby-dropped-charges-20160727-story.html; Mara Gay and Zolan Kanno-Youngs, *Mayor Bill de Blasio's Comments on Shootings Draw Criticism From Police Union*, Wall Street Journal (July 7, 2016), *available at* http://www.wsj.com/articles/mayor-bill-de-blasios-comments-on-shootings-draw-criticism-from-police-union-1467940940.

9 *60% Say Race Relations Have Gotten Worse Since Obama's Election*, Rasmussen Reports (July 19, 2016, *available at* http://www.rasmussenreports.com/public_content/politics/current_events/social_issues/60_say_race_relations_have_gotten_worse_since_obama_s_election.

10 *Views on Police Discrimination Little Changed Since Ferguson*, Rasmussen Reports (July 14, 2016), *available at* http://www.rasmussenreports.com/public_content/lifestyle/general_lifestyle/july_2016/views_on_police_discrimination_little_changed_since_ferguson.

11 Bill Chappell, *5 Former New Orleans Police Officers Plead Guilty Over Danziger Bridge Killings*, NPR (April 20, 2016), *available at* http://www.npr.org/sections/thetwo-way/2016/04/20/474973779/5-former-new-orleans-police-officers-enter-guilty-pleas-over-danziger-bridge-kil.

12 The graphic video is available at https://www.youtube.com/watch?v=fg3GrfR2wiQ&oref=https%3A%2F%2Fwww.youtube.com%2Fwatch%3Fv%3Dfg3GrfR2wiQ&has_verified=1.

13 Wesley Lowery, Kimberly Kindy, Keith L. Alexander, Julie Tate, Jennifer Jenkins, Steven Rich, *Distraught People, Deadly Results*, The Washington Post (June 30, 2015), *available at* http://www.washingtonpost.com/sf/investigative/2015/06/30/distraught-people-deadly-results/; Phillip Swarts, *Police need better training and community relations, presidential task force is told*, The Washington Times (Jan. 13, 2015), *available at* http://www.washingtontimes.com/news/2015/jan/13/police-brutality-solutions-are-training-community-/; Timothy Williams, *Long Taught to Use Force, Police Warily Learn to De-escalate*, New York Times (June 27, 2015), *available at* http://www.nytimes.com/2015/06/28/us/long-taught-to-use-force-police-warily-learn-to-de-escalate.html?_r=0; Leila Atassi, *Lawsuits against city of Cleveland blame poor training for police use of excessive force: Forcing Change*, Cleveland.com (Jan. 27, 2015), *available at* http://www.cleveland.com/forcing-change/index.ssf/2015/01/lawsuits_against_city_of_cleve.html.

14 Sewell Chan, *The Abner Louima Case, 10 Years Later*, New York Times (Aug. 9, 2007), *available at* http://cityroom.blogs.nytimes.com/2007/08/09/the-abner-louima-case-10-years-later/.

15 *Department of Justice Report Regarding The Criminal Investigation Into The Shooting Death Of Michael Brown By Ferguson, Missouri Police Officer Darren Wilson*, Department of Justice (March 4, 2015), *available at* https://www.justice.gov/sites/default/files/opa/press-releases/attachments/2015/03/04/doj_report_on_shooting_of_michael_brown_1.pdf.

16 Jake Halpern, *The Cop*, The New Yorker (Aug. 10, 2015), *available at* http://www.newyorker.com/magazine/2015/08/10/the-cop; John Bacon, *Darren Wilson: Ferguson made me unemployable*, USA Today (Aug. 4, 2015), *available at* http://www.usatoday.com/story/news/nation/2015/08/04/darren-wilson-ferguson-shooting-made-him-unemployable/31097619/.

that Brown's "killer walked away,"[17] and Michael Brown's mother (whose personal grief is, of course, understandable) was invited to the stage at the Democratic National Convention.[18]

Mac Donald chronicles the events in Ferguson, including the ensuing riots, which have been repeated to devastating effect in other cities following police-citizen confrontations. She argues that the increasing hostility toward—and murder of—police officers has led to a "Ferguson Effect" in which police officers in some communities are standing down by cutting back on proactive policing particularly in high crime areas out of fear for their safety or of being falsely accused of racism, which is, in turn, leading to more crime.[19]

While some question whether the Ferguson Effect is real,[20] there is considerable support for the phenomenon. As a veteran Boston police officer recently stated, "Sometimes we feel like our hands are tied behind our backs and people are out to get us."[21] Although reluctant to use the term "Ferguson Effect," FBI Director James Comey admitted to being deeply concerned about the uptick in violence in many of our inner cities and stated that he has "a strong sense that some part of the explanation is a chill wind blowing through American law enforcement over the last year. And that wind is surely changing [police] behavior."[22] After analyzing data from ten cities that saw a 33% increase in homicides in 2015 and which have large African American populations, Richard Rosenfeld, a well-respected criminologist who was initially skeptical of the existence of the Ferguson Effect, now says that "[t]he only explanation that gets the timing right is a version of the Ferguson effect," which is now his "leading hypothesis" to explain the dramatic increase in crime.[23]

Are law enforcement officers nervous? No doubt, and for good reason. Tensions are high. According to Donald Mihalek of the Federal Law Enforcement Officers Association, forensic studies have established that a suspect with a gun in his waistband can draw and fire his weapon in 0.8 seconds, faster than the time it takes for an officer to respond.[24] Moreover, Mac Donald contends, "an officer's chance of getting killed by a black assailant is 18.5 times higher than the chance of an unarmed black person getting killed by a cop."[25] When police officers in tense and unknown circumstances hesitate to act, they die.[26]

Fearing for their safety, officers in major cities are increasingly patrolling in pairs,[27] and in Baltimore, where crime rates

17 Video available at http://video.foxnews.com/v/5029892075001/rev-jesse-jackson-theres-a-backlog-of-pain-in-america/?#sp=show-clips.

18 Chuck Raasch and Christine Byers, *Michael Brown's mother appears at Democratic National Convention, prompting police ire*, St. Louis Post-Dispatch (July 27, 2016), *available at* http://www.stltoday.com/news/local/metro/michael-brown-s-mother-appears-at-democratic-national-convention-prompting/article_4b4e6e1a-55c7-5267-828a-e74472b0a7ee.html.

19 It is worth noting that some see this as a positive development. *See Moving Past 'Broken Windows' Policing*, New York Times (Aug. 10, 2016), *available at* http://www.nytimes.com/2016/08/10/opinion/moving-past-broken-windows-policing.html.

20 *See, e.g.*, Kali Holloway, *There is no Ferguson effect: New Data confirm the war on police is a right-wing myth*, Salon (May 27, 2016), *available at* http://www.salon.com/2016/05/27/the_war_on_police_is_a_myth_new_data_throroughly_debunk_a_noxious_right_wing_talking_point_partner/; Allen Steinberg, *The persistent myth of the 'Ferguson effect'*, Reuters (Jan. 18, 2016), *available at* http://blogs.reuters.com/great-debate/2016/01/18/the-persistent-myth-of-the-ferguson-effect/; Leon Neyfakh, *There Is No Ferguson Effect*, Slate (Nov. 20, 2015), *available at* http://www.slate.com/articles/news_and_politics/crime/2015/11/ferguson_effect_it_s_not_real_but_urban_murder_spikes_are.html.

21 Nestor Ramos, *In Dallas' wake, fear among local officers*, Boston Globe (July 9, 2016), *available at* https://www.bostonglobe.com/metro/2016/07/09/dallas-wake-fear-force/Zboyin6kmCaLDn2w9NwRaN/story.html?comments=all&sort=NEWEST_CREATE_DT.

22 Law Enforcement and the Communities We Serve: Bending the Lines Towards Safety and Justice, Remarks of FBI Director James B. Comey at University of Chicago Law School (October 23, 2015), *available at* https://www.fbi.gov/news/speeches/law-enforcement-and-the-communities-we-serve-bending-the-lines-toward-safety-and-justice.

23 Lois Beckett, *Is the 'Ferguson effect' real? Researcher has second thoughts,* The Guardian (May 13, 2016), *available at* https://www.theguardian.com/us-news/2016/may/13/ferguson-effect-real-researcher-richard-rosenfield-second-thoughts.

24 Donald J. Mihalek, *Use of Force vs. Use of Farce*, The Daily Caller (July 25, 2016), *available at* http://dailycaller.com/2016/07/25/use-of-force-vs-use-of-farce/. In some police academies, officers are still taught the "21 Foot Rule" (sometimes referred to as the "Tueller Drill" after the man who devised it, Lt. John Tueller), which provides that an average person with a knife can cover a distance of 21 feet in the time it would take a police offer to recognize the threat, unholster his weapon, and fire at the assailant, although some have questioned the wisdom and validity of this training technique. *See* Ron Martinelli, *Revisiting the "21-Foot Rule"*, Police (Sept. 18, 2014), *available at* http://www.policemag.com/channel/weapons/articles/2014/09/revisiting-the-21-foot-rule.aspx.

25 To view a disturbing montage of police officers being shot by assailants of different races, see https://www.youtube.com/watch?v=q-PnrtUPPUs.

26 To those who believe that police officers have particularly itchy trigger fingers when confronting African Americans, research suggests that, in fact, if anything, officers take longer to shoot black suspects than they do to shoot white or Hispanic suspects. Lois James, David Klinger, and Bryan Vila, *Racial and ethnic bias in decisions to shoot seen through a stronger lens: experimental results from high-fidelity laboratory simulations*, Journal of Experimental Criminology (May 2014), *available at* https://www.researchgate.net/publication/269354127_Racial_and_ethnic_bias_in_decisions_to_shoot_seen_through_a_stronger_lens_Experimental_results_from_high-fidelity_laboratory_simulations. Moreover, research indicates that white officers have lower "threat perception failures" (perceiving that a suspect is armed when he is not) than black or Hispanic officers when it came to confronting black suspects. George Fachner and Steven Carter, *An Assessment of Deadly Force in the Philadelphia Police Department,* Report by the Department of Justice's Office of Community Oriented Policing Services and CNA (April 2015), *available at* http://ric-zai-inc.com/Publications/cops-w0753-pub.pdf. Research also indicates that, if anything, police officers are less trigger happy than members of the affected communities when it comes to making shoot-don't-shoot decisions, especially when the suspect is African American. Joshua Correll, Bernd Wittenbrink, Tracie Keesee, Bernadette Park, Charles M. Judd, and Melody S. Sadler, *Across the Thin Blue Line: Police Officers and Racial Bias in the Decision to Shoot*, Journal of Personality and Social Psychology, 2007, Vol. 92, No. 6, 1006-1023, *abstract available at* http://www.ncbi.nlm.nih.gov/pubmed/17547485.

27 Sadie Gurman, *Police Across US Patrolling in Pairs After Ambush Attacks*, Providence Journal (July 19, 2016), *available at* http://www.providencejournal.com/news/20160719/police-across-us-patrolling-in-pairs-after-ambush-attacks; Kelly Cohen, *Police officers in major U.S. cities to patrol in pairs*, Washington Examiner (July 8, 2016), *available at* http://www.washingtonexaminer.com/police-officers-in-major-u.s.-cities-to-patrol-in-pairs/article/2595982.

have shot through the roof (murders have increased by 63% in 2015), police officers have quit in large numbers.[28] Who can blame them? Through August 1, 2016, firearms-related killings of law enforcement officers are up a staggering 70% over this period last year (from 20 to 34)[29] and ambush killings are up nearly 400% (3 to 14),[30] according to data compiled by the National Law Enforcement Officers Memorial Fund. In 2014, law enforcement officers were assaulted 15,725 times, resulting in 13,824 injuries;[31] those numbers are likely up too this year. While these figures have been worse in years past,[32] they are, nonetheless, deeply disturbing. And while there may be other factors contributing to the recent upsurge in violent crime—such as the heroin epidemic and the violence that has ensued as Mexican drug cartels and affiliated gangs compete for new customers and territories[33]—any hesitancy by police officers to engage in discretionary proactive law enforcement efforts will only serve to exacerbate an already bad situation.

Unfortunately, the facts seem to bear this out. Homicide rates in 56 large U.S. cities were up approximately 17% in 2015 over 2014 (much more in some cities), the largest increase in a quarter century.[34] Homicide rates have continued to rise at an alarming rate during the first half of 2016; they are up another 15% in 51 large cities that have reported data, according to the Major Cities Chiefs Association.[35] While some cities, such as Milwaukee, have seen declines, others such as Chicago have seen dramatic increases (316 homicides in the first half of 2016, compared to 211 in the first half of 2015).[36] And it's not just homicides that are up in the first half of this year; there have been more than 600 more non-fatal shootings, over 1,000 more robberies, and nearly 2,000 more aggravated assaults compared to the first half of last year.[37] Again, violent crime rates are still substantially below where they were in the 1960s through the early 1990s, but this reversal is quite dramatic, and the trend is quite alarming. What is needed to combat crime in communities of color is *more* of a police presence, not less.

If the body count is racking up in many of our inner cities, it is not because police officers are wantonly shooting black people; it is because black people, predominantly black men, are shooting each other. As Mac Donald correctly notes, "young black men commit homicide at nearly ten times the rate of young white and Hispanic males combined," and their victims are overwhelmingly other black residents who live in their communities. In Chicago, for instance, in 2015, 2,460 African American people were shot (nearly seven each day), compared to only 78 white people (one every 4.6 days); in 2011 (the last year for which data was released by the Chicago police), 71% of those committing murder were black and 75% of murder victims were black.[38] Homicide is now the number one cause of death among African Americans between the ages of 1 and 44.[39] And, Mac Donald adds, "until the black crime rate comes down, police presence is going to be higher in black neighborhoods, increasing the chance that when police tactics go awry, they will have a black victim."

As Mac Donald points out, nobody on the Left seem to want to talk about how the crime problem in our inner cities has been exacerbated by, among other things, rampant drug use, high dropout rates, and the breakdown of the family structure, where over 70% of African American children are now born to single mothers.[40] Mac Donald also notes that nobody wants to talk about the fact that the people who benefit the most from aggressive policing are law-abiding African Americans who live in the inner cities and are trying to lead decent lives, but are afraid to go out at night, let their children play outside, or go to work. These same people also lose much-needed goods, services, and jobs because entrepreneurs refuse to open businesses in crime-plagued communities; as Mac Donald reminds us, "Lowered crime is a

28 Blake Neff, *Cops Quit Baltimore Force In Droves While Murder Soars*, Daily Caller (July 7, 2016), *available at* http://dailycaller.com/2016/07/07/cops-quit-baltimore-force-in-droves-while-murder-soars/.

29 *Preliminary 2016 Law Enforcement Officer Fatalities*, National Law Enforcement Officers Memorial Fund (as of Aug. 1, 2016), *available at* http://www.nleomf.org/facts/officer-fatalities-data/.

30 *Latest Memorial Fund Fatalities Report*, National Law Enforcement Officers Memorial Fund (as of Aug. 1, 2016), *available at* http://www.nleomf.org/facts/research-bulletins/; *2016 Mid-Year Enforcement Officer Fatalities Report*, National Law Enforcement Officers Memorial Fund (as of Aug. 1, 2016), *available at* http://www.nleomf.org/assets/pdfs/reports/2016-Mid-Year-Officer-Fatalities-Report.pdf.

31 *Law Enforcement Facts*, National Law Enforcement Officers Memorial Fund (as of Aug. 1, 2016), *available at* http://www.nleomf.org/facts/enforcement/.

32 *Officer Deaths by Year*, National Law Enforcement Officers Memorial Fund (as of Aug. 1, 2016), *available at* http://www.nleomf.org/facts/officer-fatalities-data/year.html.

33 *See* Richard Rosenfeld, *Documenting and Explaining the 2015 Homicide Rise: Research Directions*, National Institute of Justice (June 2016), *available at* https://www.ncjrs.gov/pdffiles1/nij/249895.pdf; Sean Kennedy, *Is heroin behind the crime spike? New evidence suggests so*, American Enterprise Institute (June 27, 2016), *available at* https://www.aei.org/publication/is-heroin-behind-the-crime-spike-new-evidence-suggests-so/.

34 Rosenfeld, *supra* note 33.

35 Zusha Elinson, *Murders Rise in 29 of Largest U.S. Cities in First Half of 2016*, Wall Street Journal (July 25, 2016), *available at* http://www.wsj.com/articles/murder-rate-rises-in-29-of-largest-u-s-cities-in-first-half-of-2016-1469485481. *See also* Derek Hawkins, *Monday was Chicago's worst day in more than a decade for homicides, with 9 people fatally shot*, The Washington Post (Aug. 10, 2016), *available at* https://www.washingtonpost.com/news/morning-mix/wp/2016/08/10/nine-people-fatally-shot-in-chicago-marking-citys-deadliest-day-in-more-than-a-decade-10-more-wounded/.

36 *Id.*

37 Wesley Bruer, *Violent crime rising in US cities, study finds*, CNN (July 26, 2016), *available at* http://www.cnn.com/2016/07/25/politics/violent-crime-report-us-cities-homicides-rapes/.

38 Devin Foley, *Chicago: 75% of Murdered are Black, 71% of Murderers are Black*, Intellectual Takeout (July 27, 2016), *available at* http://www.intellectualtakeout.org/blog/chicago-75-murdered-are-black-71-murderers-are-black.

39 Dhruv Khullar and Anupam B. Jena, *Homicide's Role in the Racial Life-Expectancy Gap*, Wall Street Journal (April 27, 2016), *available at* http://www.wsj.com/articles/homicides-role-in-the-racial-life-expectancy-gap-1461797871.

40 Births: Final Data for 2014, National Vital Statistics Reports, Vol. 64, No. 12 (Dec. 23, 2015), at page 7 & Table 115, *available at* http://www.cdc.gov/nchs/data/nvsr/nvsr64/nvsr64_12.pdf. That is the nationwide average; the numbers are much higher in some of our inner cities, where supportive fathers seem scarce.

precondition to economic revival, not its consequence." Any dialogue between the police and local community leaders ought to acknowledge and address these issues too if any real progress is likely to occur.

The War on Cops is not without its flaws. There were times (several actually) where I found Mac Donald's rhetoric too acerbic, and she makes some arguments with which I am sympathetic but not in complete agreement. For example, she is vehemently opposed to the criminal justice reform movement ("America does not have an incarceration problem; it has a crime problem."), whereas I have written[41] and spoken[42] in favor of some forms of criminal justice reform. Mac Donald states that those who favor criminal justice reform do so because they contend, falsely, that our country has a "mass incarceration" problem or because the criminal justice system is suffused with racism—neither of which I believe. Nonetheless, Mac Donald's views on this topic, as on all others she covers, are as thoughtful and articulate as they are provocative.

Law enforcement officers have a difficult and dangerous job to do. As former President George W. Bush said at the recent memorial service honoring the five slain Dallas law enforcement officers, "Most of us imagine if the moment called for [it], that we would risk our lives to protect a spouse or a child. Those wearing the uniform assume that risk for the safety of strangers. They and their families share the unspoken knowledge that each new day can bring new dangers."[43]

We should never forget it and should honor and support those whose job it is "to swallow the sorrows of humanity—from the banal to the truly tragic—and to return to work the next day and do it all over again."[44] As Heather Mac Donald points out time and again in *The War on Cops*, things are bad. They could, however, get much worse. After all, Mac Donald notes, "The trend of increasing crime rests on firmer statistical evidence than does the claim that we are living through an epidemic of racist police killings."

41 John G. Malcolm, *Criminal Justice Reform at the Crossroads*, Texas Review of Law & Politics, Vol. 20, No. 2, pgs. 249-293 (Spring 2016), *available at* http://trolp.org/wp-content/uploads/2016/06/FINAL-FORMAT-Malcolm_Website-1.pdf.

42 John G. Malcolm, *Criminal Justice Reform*, Testimony before the Committee on Oversight and Government Reform, U.S. House of Representatives (July 15, 2015), *available at* https://oversight.house.gov/wp-content/uploads/2015/07/Malcolm-Heritage-Statement-7-15-Criminal-Justice-II-COMPLETE.pdf.

43 *George W. Bush's Remarks at Dallas Memorial Service*, U.S. News & World Report (July 12, 2016), *available at* http://www.usnews.com/news/articles/2016-07-12/transcript-george-w-bushs-remarks-at-dallas-memorial-service.

44 Graham Campbell, *Why Cops Like Me Are Quiet*, BuzzFeed News (May 6, 2015), *available at* https://www.buzzfeed.com/dreamworks/why-cops-like-me-stay-quiet-about-police-brutality?utm_term=.xddbmDry#.xnv4ZMb3.