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The Journal of the Federalist Society Practice Groups

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Catch or Release? The Employment Non-Discrimination Act's Exemption for Religious Organizations
by Steven H. Aden & Stanley W. Carlson-Thies

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Recent Developments in Election Law
by Kathryn Biber & John Hilton

Obama's War Law
by Robert J. Delahunty

Shady Grove v. Allstate*: A Case Study in Formalism Versus Pragmatism*
by Aaron D. Van Oort & Eileen M. Hunter

BOOK REVIEWS

Voting Rights – and Wrongs: The Elusive Quest for Racially Fair Elections by Abigail Thernstrom
& The Vanishing American Lawyer by Thomas D. Morgan

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Likewise, we hope that members find the work in the pages to be well-crafted and informative. Articles are typically chosen by our Practice Group chairmen, but we strongly encourage members and general readers to send us their commentary and suggestions at info@fed-soc.org.

Volume 11, Issue 2 | Engage | September 2010

Engage

Civil Rights

Catch or Release? The Employment Non-Discrimination Act's Exemption for Religious Organizations
by Steven H. Aden & Stanley W. Carlson-Thies 4

Corporations, Securities & Antitrust

How the Proposed Amendments to the Organizational Sentencing Guidelines Will Affect Corporate Compliance and Ethics Programs
by Michael H. Huneke 10

NOL Pill Reloaded: *Selectica, Inc. v. Versata Enterprises, Inc.*
by Robert T. Miller 15

Criminal Law & Procedure

The Inadequate Jurisprudence of Adequate State Grounds
by Kent Scheidegger & Tom Gede 21

Swinging a Sledge: The Right to Effective Assistance of Counsel, the Law of Deportations, and *Padilla v. Kentucky*
by Joseph M. Ditkoff 25

Environmental Law & Property Rights

Modern Remedies for Antiquated Laws: Challenging National Monument Designations Under the 1906 Antiquities Act
by Mark C. Rutzick 29

Federalism & Separation of Powers

Legal and Logistical Ramifications of the National Popular Vote Plan
by Tara Ross 37

Financial Services & E-Commerce

The "Volcker Rule": Barring Banking Organizations from Proprietary Trading, Fund Investment, and Sponsorship
by Julius L. Loeser 45

Free Speech & Election Law

Recent Developments in Election Law
by Kathryn Biber & John Hilton 50

The Potential Impact on Campaign Finance Regulation of *SpeechNow.org v. FEC*
by Douglas Chalmers, Jr. & Michael Jablonski 57

Intellectual Property

Impediments to Innovation: Implications of National Health Care Legislation for the Intellectual Property Community
by David Applegate & Arthur Gollwitzer III 64

Trademark, Copyright, and the Internet: Time to Return Balance to Civil Litigation
by Ronald D. Coleman 69

Wyeth v. Kappos: The United States Patent Office Is Forced to Change Course
by John C. Freeman 74

International & National Security Law

Obama's War Law
by Robert J. Delahunty 80

Labor & Employment Law

Does the First Amendment Allow States to Compel Recipients of Government Monies to Support State-Designated Representatives?
by William L. Messenger 88

Litigation

Amending the Federal Rules (Again): Finding the Best Path to an Effective Duty to Preserve
by Thomas Y. Allman 92

Vermont Attorney General Uses State Consumer Fraud Statute to Implement Consumer Product Penalties
by Hal Stratton 96

State "Anti-SLAPP" Statutes Codify First Amendment Doctrine Protecting a Corporation's Right to Petition
by Raymond J. Tittmann 98

Shady Grove v. Allstate: A Case Study in Formalism Versus Pragmatism
by Aaron D. Van Oort & Eileen M. Hunter 105

Professional Responsibility & Legal Education

Should the Public Be Able to Buy Stock in Law Firms?
by Thomas D. Morgan 111

Religious Liberties

The Montana Supreme Court Legalizes Assisted Suicide
by William L. Saunders 114

Telecommunications & Electronic Media

National Broadband Plan
by Howard Waltzman 119

Book Reviews

Voting Rights—and Wrongs: The Elusive Quest for Racially Fair Elections by Abigail Thernstrom
Reviewed by Roger Clegg 123

We're Not Dead yet. Book Review: The Vanishing American Lawyer by Thomas D. Morgan
by Allison R. Hayward 125

Civil Rights

Catch or Release? The Employment Non-Discrimination Act's Exemption for Religious Organizations

By Steven H. Aden, Esq. & Stanley W. Carlson-Thies, Ph.D.***

The "Employment Non-Discrimination Act" ("ENDA") currently under consideration in Congress would in effect[1] expand Title VII of the 1964 Civil Rights Act to add "sexual orientation" and "gender identity"(transgender status) to the list of statuses protected under federal law from employment discrimination. ENDA has been introduced in various forms since the 1970s.[2] With the increased strength of Democrats in Congress and the backing of President Barack Obama,[3] ENDA's prospects for enactment have improved.[4]

ENDA's proponents assert that the bill promotes the goal of embracing diversity in the workplace. Proponents also argue that sexual orientation is protected under the U.S. Constitution's guarantees of equal protection and due process. Without a federal statute, they claim, victims of discrimination are subject to a patchwork of state-law protections that provide uneven and often insufficient protection, hence the need for a national standard in the form of ENDA.

Critics argue that antidiscrimination laws promote *intolerance* of faith if they are not accompanied by meaningful exemptions for religious organizations and other faith-based employers with religiously grounded moral objections to homosexual conduct.[5] Without strong exemptions, religious organizations will be required, as a condition of seeking workers to carry out their faith-based missions, to affirm conduct that is in diametric opposition to the moral principles of their faith. Critics assert that, unlike other established statutory protections such as race and gender, legal protections for sexual orientation inevitably clash with the right to free exercise and expression of religion, including the right to believe and express that homosexual conduct is sinful.

In the words of the Supreme Court, protecting expressive associations from antidiscrimination laws "is crucial in preventing the majority from imposing its views on groups that would rather express other, perhaps unpopular ideas."[6] This concern has been acknowledged by a number of ENDA's proponents[7] and thus ENDA bills have routinely incorporated an exemption for religious organizations. The key question for this article is whether the proffered religious exemption adequately protects the religious freedom of religious organizations; in a phrase, will the circle drawn by the exemption operate to "catch" or "release" faith-based institutions?[8]

ENDA History

Until 2007, ENDA versions provided that the Act "shall not apply to a religious organization," with additional minimal language to define "religious organization."[9] In the 110th Congress, Rep. Barney Frank introduced a version (H.R. 2015) that included a complex and significantly narrower exemption.[10] After a hearing in the House Labor and Education Committee and opposition from religious freedom organizations,[11] the committee took no further action. One source of opposition was the bill's incorporation of gender identity, along with sexual orientation, as a protected status. In place of H.R. 2015, efforts turned to another Frank bill, H.R. 3685, which did not include gender identity protection but did in simple terms exempt religious organizations.[12] However, this bill additionally provided the following specific definition of such organizations:

> (A) a religious corporation, association, or society; or
>
> (B) a school, college, university, or other educational institution or institution of learning, if—
>
> (i) the institution is in whole or substantial part controlled, managed, owned, or supported by a particular religion, religious corporation, association, or society; or
>
> (ii) the curriculum of the institution is directed toward the propagation of a particular religion.[13]

The majority claimed that this definition of "religious organization" was congruent with the Title VII religious exemption: "This definition of a religious organization is taken directly from Title VII's descriptions of religious organizations exempt from that law's religious discrimination prohibitions. If an organization qualifies for Title VII's religious exemption from religious discrimination claims, it would qualify for ENDA's religious organization exemption as well."[14]

The minority complained, "H.R. 3685 revises the religious exemption, ostensibly to conform to the exemption under Title VII. The new provision, however, still fails to protect many religious organizations that would qualify for an exemption under Title VII."[15]

The bill passed the Labor and Education Committee along party lines, with four Republican amendments offered and rejected.[16] Two amendments offered by Rep. Mark Souder would have eliminated the protection for "perceived" sexual orientation and permitted employers to condition employment on being married or being eligible to marry.[17] A third Souder amendment would have prohibited retaliation against an employee who refused to sign an employer's anti-discrimination or anti-harassment policy or refused to participate in diversity training because such policy is against the individual's religious beliefs regarding homosexual conduct.[18] The fourth amendment, offered by Rep. Pete Hoekstra, would have expanded the religious exemption to include institutions that maintain a faith-based mission, although they are not

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controlled by a church or denomination. The committee, in rejecting the Hoekstra amendment, again stated: "H.R. 3685 adopts Title VII's definition of a religious organization and thereby imports long-standing existing law on who is or is not a religious organization. The scope of its religious exemption is to those organizations who are covered by Title VII's exemption, no more and no less."[19]

However, religious-freedom and faith-based organizations protested that the scope of the proposed ENDA religious exemption was narrower than Title VII's exemption, due to the definition of "religious organization" incorporated into ENDA. Because of that definition, seminaries (by virtue of their curriculum) and church-controlled colleges (by virtue of that denominational control) would be exempt from ENDA but a nondenominational liberal arts college such as Wheaton College, Illinois, would not be exempt.[20]

When the bill moved to consideration on the House floor, several amendments were offered. Important for this discussion is the friendly amendment offered by Rep. George Miller, a co-sponsor of the bill. This amendment incorporated by reference the actual language of Title VII's religious exemption: "This Act shall not apply to a corporation, association, educational institution, or society that is exempt from the religious discrimination provisions of title VII of the Civil Rights Act of 1964 pursuant to section 702(a) or 703(e)(2) of such Act (42 U.S.C. 2000e-1(a); 2000e-2(e)(2))."[21]

Rep. Souder offered an amendment to strike the bill's prohibition of employers conditioning employment on a person being married or being eligible to be married.[22] The amendment passed overwhelmingly, by a vote of 325-101.[23] A third amendment, offered by Rep. Tammy Baldwin, to add "gender identity" to the bill's protections, was withdrawn by unanimous consent after discussion.[24] Thus amended, the bill passed the House by a vote of 235-184, but the Senate took no action.[25]

The effort to pass an ENDA bill has been renewed in the 111th Congress, with two new versions of ENDA having been introduced by Rep. Frank on June 19, 2009 (H.R. 2981), and June 24, 2009 (H.R. 3017), and a third bill in the Senate by Sen. Jeff Merkley (S. 1584). All of these new versions recapitulate the exemption for religious institutions based on Title VII's exemption as previously set out in H.R. 3685 (110th Cong.), as modified by the Miller Amendment on the floor.[26] All three versions also add "gender identity" as a protected status, and provide that ENDA gives no protection against discrimination based on "unmarried" status, with "marriage" defined by reference to the federal Defense of Marriage Act.[27]

Analysis of the Religious Exemption in the Current ENDA Bills

The first part of the religious exemption incorporated by reference into ENDA, Section 2000e-1(a), is a general exemption for religious hiring by religious entities. Sec. 2000e-1(a) provides that Title VII "shall not apply to . . . a religious corporation, association, educational institution, or society with respect to the employment of individuals of a particular religion to perform work connected with the carrying on by such corporation, association, educational institution, or society of its activities." This provision has been quite broadly construed by the courts, and its protections for hiring based upon religious status or beliefs have been routinely applied to churches, faith-based nonprofit organizations, and religious educational institutions.[28] However, there have been disputes in the courts regarding some institutions' eligibility for the exemption, and these disputes lead to intrusive analyses of the institutions' religious beliefs and practice to determine whether they, and thus their employment practices, are exempt.[29] This uncertainty renders the religious exemption something less than a reliable categorical protection from litigation, and thus exempting religious organizations from ENDA's strictures by referencing the Title VII exemption provides to religious organizations something less than complete confidence in making employment decisions involving sexual status and conduct.[30]

The second part of the Title VII exemption, Section 2000e-2(e)(2), protects religious hiring in religious education by providing,

> [I]t shall not be an unlawful employment practice for a school, college, university, or other educational institution or institution of learning to hire and employ employees of a particular religion if [the institution] is, in whole or in substantial part, owned, supported, controlled, or managed by a particular religion or by a particular religious corporation, association, or society, or if the curriculum of such school, college, university, or other educational institution or institution of learning is directed toward the propagation of a particular religion.[31]

There is a paucity of case law interpreting the provision, likely because many consider it redundant of the general exemption provided in 2000e-1(a). What precedent exists suggests that analysis under this provision follows one or both of two distinct lines of inquiry: the "control or support test" and the "curriculum" test. The former test is more commonly applied, with varied results.[32] The Ninth Circuit utilized the curriculum test in *EEOC v. Kamehameha Schools/Bishop Estate*, but interpreted "curriculum" narrowly in light of its context in 2000e-2(e)(2), ruled its ordinary meaning to be "limited to coursework and required school activities," and held that nothing in the school's curriculum justified the school's assertion that its teachers had to be of the Protestant faith.[33]

These Title VII statutory exemptions derive from First Amendment principles of religious exercise and church-state separation[34] that proponents argue protect the autonomy of churches and faith-based organizations by permitting them to maintain their religious mission and character by selecting employees who agree and act in accordance with the organizations' respective religious views. The Supreme Court unanimously approved the broad—institution-wide or categorical—exemption provided in 42 U.S.C. § 2000e-1, in part with the argument that

> [I]t is a significant burden on a religious organization to require it, on pain of substantial liability, to predict which of its activities a secular court will consider religious. The line is hardly a bright one, and an organization might understandably be concerned that a judge would not

understand its religious tenets and sense of mission. Fear of potential liability might affect the way an organization carried out what it understood to be its religious mission.[35]

The Court's words demonstrate how important it is that the Title VII religious exemption is categorical or institution-wide, rather than being limited to purportedly "religious" or "ministerial" posts within an organization.[36] Assuming that the courts and regulators continue to interpret the exemption broadly to include faith-based nonprofits—parachurch organizations—as well as houses of worship and denominational entitities—churches—then the current ENDA religious exemption, based on the Title VII exemption, is a strong one (although, as noted above, courts at times have been uncertain about whether particular organizations should be included among the religious entities referenced in the Title VII exemption). Given how important the moral issues implicated in sexual conduct are regarded to be by many religious communities and their religious organizations, this categorical ENDA exemption is an important confirmation of religious freedom.

However, the authors believe that, to be effectual, the current ENDA exemption needs to be supplemented.[37] The intent of the changes would not be to expand the religious exemption but rather to ensure that it is carried out in the practice of court and regulatory decisions. We note two areas of concern.

The first might be called the "*Bob Jones*" issue: the creation of a compelling governmental interest that is held to overbalance religious freedom claims.[38] With regard to ENDA the concern is the possibility that a court, notwithstanding ENDA's religious exemption, would regard the enactment of ENDA to have created a compelling governmental interest in suppressing certain forms of employment discrimination, undermining ENDA's supposed acknowledgement of the freedom for religious organizations to engage in those forms of employment decisionmaking.[39] The 1990 Supreme Court decision, *Employment Division* v. *Smith*,[40] limited the constitutional requirement to minimize burdens on religious exercise, such that legislatures must now take exceptional care in drafting statutes in order to preserve religious freedom in the context of a generally applicable law such as ENDA. The Religious Freedom Restoration Act of 1993[41] was enacted to restore the pre-Smith "compelling interest" standard and thereby again to more robustly protect religious freedom. Yet, in the current environment of heightened activism, some may say that by adopting ENDA Congress has implicitly announced that the federal government has a "compelling interest" *not* to accommodate the employment practices of religious organizations even though compliance with ENDA would substantially burden their religious exercise.

This problem might be addressed by adding a statement in the "purposes" section of ENDA that announces the congressional intention not to inadvertently undermine religious freedom in the course of enhancing employment nondiscrimination protections.[42] Similarly, in the "construction" section of ENDA a statement could be added saying that ENDA shall not be construed to have created a compelling governmental interest in the context of claims arising from the First Amendment or from the Religious Freedom Restoration Act.[43]

The second area of concern about how practically efficacious the religious exemption might be in our current era of activism might be labeled the "*Boy Scouts*" problem: the courts hold that some action is constitutionally protected but governmental entities retaliate against organizations that engage in that action by withdrawing from them various benefits.[44] The likelihood of such retaliation is not limited to the Boy Scouts, of course, and legislatures have acted in advance to forestall retaliation when dealing with volatile issues. The retaliation by public officials against the Boy Scouts following the Supreme Court decision upholding the organization's policy on openly homosexual Scoutmasters led Congress to adopt the Boy Scouts of America Equal Access Act (2002).[45] Congressional efforts to protect medical personnel and institutions that object to performing or aiding in abortions has gone beyond legal prohibitions to include provisions to protect objecting persons and institutions from being penalized by government action. The 1996 Danforth Amendment forbids governmental entities from denying "federal financial assistance, certifications, or licenses" to doctors, students, and training programs because of their refusal to support abortions.[46] Similarly, the Weldon Amendment, added to appropriations bills since 2004, withholds appropriated funds from any federal, state, or local governmental entity that discriminates against a health institution or professional because of the institution's or person's lack of support for abortion.[47] The same-sex marriage law adopted in New Hampshire not only provides that religious organizations cannot be compelled to provide services, facilities, and the like to aid in the solemnization or promotion of same-sex marriages but specifically provides that a refusal to provide such services, facilities, etc., "shall not create any civil claim or cause of action or result in any state action to penalize or withhold benefit from such religious organization, association, or society . . . ."[48] The Canadian same-sex marriage act (Bill C-38) includes language amending the Income Tax Act to ensure that religious charities do not lose their registration consequent to exercising their freedom not to support marriages that conflict with their fundamental convictions.[49]

By enacting such provisions, legislatures have acknowledged the importance of providing statutory protection to exempted religious organizations against likely retaliatory action. New ENDA language could provide that religious organizations are not to be subject to retaliation by governmental entities, such as the loss of licenses, permits, grants, tax-exempt status, etc., on the grounds that the religious organization is entitled to the religious exemption or because it has utilized the exemption and engaged in otherwise prohibited employment decisions.[50]

The goal of such changes would not be to expand the religious freedom protections afforded by the religious exemption in ENDA but rather to ensure that those protections are made effective in governmental practice and court decisions. The authors of, and advocates for, ENDA have often stated that it is their intention to suppress employment discrimination against persons who regard themselves as homosexuals or transgendered, but that it is not their intention to suppress

the freedom of religious organizations to follow their religious convictions about these matters in their employment decisions. For that balance of anti-discrimination action with protection for religious freedom to be implemented in practice, the formal words of the religious exemption need to be supplemented by provisions restricting governmental action that undermines the exemption.

Endnotes

1 ENDA does not amend Title VII itself. Indeed, as discussed below, the exemption for religious organizations contained in the current versions of ENDA specifically reference the Title VII exemption for religious organizations and provide that an organization entitled to that exemption would be exempt from ENDA's sexual orientation and gender identity discrimination prohibitions. Conversely, if ENDA amended Title VII by adding sexual orientation and gender identity as statuses protected by Title VII, then religious organizations would be subject to these new nondiscrimination requirements, for the religious exemption in Title VII only exempts religious organizations from the requirement not to engage in religious employment discrimination, while not removing the obligation not to engage in employment discrimination with respect to the other protected statuses.

2 *See, e.g.*, S. 1705, § 9 (introduced Oct. 2, 2003); H.R. 3285, § 9 (introduced Oct. 8, 2003); H.R. 2692, § 9 (introduced July 31, 2001); S. 869, § 9 (introduced June 10, 1997); H.R. 4636 § 6(a) (introduced June 23, 1994). A recitation of the history of ENDA-like legislation may be found at http://thomas.loc.gov/cgi-bin/cpquery/?&dbname=cp110&sid=cp110RHAit&refer=&r_n=hr406p1.110&item=&sel=TOC_3501&.

3 According to the White House web site, "President Obama also continues to support the Employment Non-Discrimination Act and believes that our anti-discrimination employment laws should be expanded to include sexual orientation and gender identity." White House, *Issues – Civil Rights*, http://www.whitehouse.gov/issues/civil_rights/.

4 This brief article discusses only the religious exemption incorporated into recent versions of ENDA, and nothing herein should be construed as an endorsement of ENDA by the authors or the organizations with which they are associated. There are other, equally serious, concerns that ENDA presents from the standpoint of religious freedom, public policy, and practical implementation that are beyond the scope of this article, but should also be carefully considered. Among the broader religious freedom concerns are the following: ENDA does not accept the distinction made by many religions between homosexual orientation and homosexual conduct; organizations with this view do not desire to exclude from employment persons with a homosexual inclination but do insist on maintaining a sexual conduct policy that would ban sexual activity by employees outside the context of a man and woman married to each other. Adoption of ENDA may undermine the Defense of Marriage Act (DOMA) (even though the current versions of ENDA and the version adopted by the House in 2007 reference DOMA) and thus lead to the spread of "same-sex marriage," against the conviction of many religions that such unions do not constitute marriage and should not receive such recognition. While ENDA's religious exemption is an effort to protect religious organizations, it does not protect employment decisions by persons with religious or conscientious objections to homosexuality who lead organizations not regarded as "religious organizations." Such organizations may be secular entities that nevertheless desire to maintain a certain ethos to be attractive to religious customers or they may be religious businesses (e.g., a Christian bookstore), which, because they are commercial, are generally treated by the courts as not entitled to the Title VII religious exemption. For such concerns, see, e.g., Letter from the US Conference of Catholic Bishops to Members of Congress concerning ENDA, (May 19, 2010), *available at* http://www.americamagazine.org/blog/entry.cfm?blog_id=2&entry_id=2923; Thomas Messner, Heritage Foundation, ENDA and the Path to Same-Sex Marriage (Sept. 18, 2009), *available at* http://www.heritage.org/Research/Reports/2009/09/ENDA-and-the-Path-to-Same-Sex-Marriage.

5 See the excellent overview, Gregory S. Baylor & Timothy J. Tracey, *Nondiscrimination Rules and Religious Associational Freedom*, Engage, June 2007, 138, *available at* http://www.fed-soc.org/doclib/20080428_ReLibBaylor.pdf.

6 Boy Scouts of America v. Dale, 530 U.S. 640, 647-48 (2000) (upholding the right of Boy Scouts to dismiss a scoutmaster who promoted a homosexual agenda, notwithstanding antidiscrimination law). Many conservative religious organizations believe that all acts of sexual conduct outside traditional marriage are sinful, including heterosexual fornication and adultery as well as homosexual conduct. Arguably, this type of policy is not a form of "sexual orientation" discrimination. *Compare* Christian Legal Soc'y v. Walker, 453 F.3d 853, 860 (7th Cir. 2006) (Christian Legal Society "requires its members and officers to adhere to and conduct themselves in accordance with a belief system regarding standards of sexual conduct, but its membership requirements do not exclude members on the basis of sexual orientation.") *with* Christian Legal Soc'y Chapter of Univ. of Cal. v. Kane, No. C 04-04484 JSW, 2006 WL 997217, at *7 n.2 (N.D. Cal. April 17, 2006) ("Although CLS argues that it does not discriminate on the basis of sexual orientation, but merely excludes students who engage in or advocate homosexual conduct, this is a distinction without a difference.") (citing Lawrence v. Texas, 539 U.S. 558, 583 (2003) (O'Connor, J., concurring)), *aff'd on other grounds*, 2009 WL 693391 (9th Cir. March 17, 2009), *cert. granted and aff'd sub nom.* Christian Legal Soc'y Chapter of Univ. of Cal. v. Martinez, 561 U.S. ___ (2010), slip op., at 2 (Op. of Stevens, J., concurring) ("A person's religion often simultaneously constitutes or informs a status, an identity, a set of beliefs and practices, and much else besides. (So does sexual orientation, for that matter, notwithstanding the dissent's view that a rule excluding those who engage in 'unrepentant homosexual conduct' does not discriminate on the basis of status or identity.")) (citations to op. omitted).

7 Thus, for example, Rabbi David Saperstein, Director of the Religious Action Center of Reform Judaism, has testified in support of ENDA but pointed to the importance of an exemption for religious organizations:

> [T]he government is and should be free to enact legislation that protects values that differ from some of [the beliefs of religious communities]. When that occurs, however, the government also should strive to protect the freedom of religious communities with differing beliefs to practice their faith as they see fit. That is why Section 6 of ENDA, the exemption for religious organizations, is an essential part of this legislation.

Hearing on H.R. 3017, Employment Non-Discrimination Act of 2009 Before the H. Comm. on Education & Labor, 111th Cong. (2009) (statement of Rabbi David Saperstein, Director, Religious Action Center of Reform Judaism), *available at* http://edlabor.house.gov/documents/111/pdf/testimony/20090923DavidSapersteinTestimony.pdf.

8 On the validity of religious exemptions, see Carl H. Esbeck, Statutory Religious Exemptions and the Establishment Clause, 110 W. Va. L. Rev. 359 (2007); on such exemptions in the context of employment law, see Carl H. Esbeck, Stanley W. Carlson-Thies & Ronald J. Sider, Ctr. for Pub. Justice, The Freedom of Faith-Based Organizations to Staff on a Religious Basis 39-42 (2004).

9 *See generally supra* note 2.

10 H.R. 2015 provided, in section 6:

> (a) In General—This Act shall not apply to any of the employment practices of a religious corporation, association, educational institution, or society which has as its primary purpose religious ritual or worship or the teaching or spreading of religious doctrine or belief.
>
> (b) Certain Employees—For any religious corporation, association, educational institution, or society that is not wholly exempt under subsection (a), this Act shall not apply with respect to the employment of individuals whose primary duties consist of teaching or spreading religious doctrine or belief, religious governance, supervision of a religious order, supervision of persons teaching or spreading religious doctrine or belief, or supervision or participation in religious ritual or worship.
>
> (c) Conformity to Religious Tenets—Under this Act, a religious corporation, association, educational institution, or society may require that applicants for, and employees in, similar positions conform to those religious tenets that such corporation, association, institution, or society declares significant. Under this Act, such a declaration by a religious

corporation, association, educational institution or society stating which of its religious tenets are significant shall not be subject to judicial or administrative review. Any such declaration made for purposes of this Act shall be admissible only for proceedings under this act.

11 *See generally, The Employment Non-Discrimination Act of 2007: Hearing on H.R. 2015 Before the Subcomm. on Health, Employment, Labor and Pensions, H. Comm. on Education and Labor*, 110th Cong. (2007) (comments of Alliance Defense Fund, Concerned Women for America, Center for Law and Religious Freedom of the Christian Legal Society, American Center for Law & Justice, General Conference of Seventh-Day Adventists, Union of Orthodox Jewish Congregations, National Conference of Catholic Bishops, American Association of Christian Schools, Traditional Values Coalition, the Ethics and Religious Liberty Commission of the Southern Baptist Convention, Family Research Council, and others), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname= 110_house_hearings&docid=f:37637.pdf.

12 H.R. 3685, 110th Cong. (as reported in House, Sept. 27, 2007), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3685rh.txt.pdf.

13 *Id.* Sec. 3(8).

14 House Report 110-406 – Part 1 – Employment Non-Discrimination Act of 2007, Section-By-Section Analysis, http://www.thomas.gov/cgi-bin/cpquery/?&dbname=cp110&sid=cp110jUvSC&refer=&r_n=hr406p1.110&item=&sel=TOC_104577& (last visited July 6, 2010).

15 House Report 110-406 – Part 1 – Employment Non-Discrimination Act of 2007, Minority Views, http://www.thomas.gov/cgi-bin/cpquery/?&dbname=cp110&sid=cp110jUvSC&refer=&r_n=hr406p1.110&item=&sel=TOC_129849& (last visited July 6, 2010).

16 House Report 110-406 – Part 1 – Employment Non-Discrimination Act of 2007, Committee Action Including Legislative History and Votes, http://www.thomas.gov/cgi-bin/cpquery/?&dbname=cp110&sid=cp110X5NC4&refer=&r_n=hr406p1.110&item=&sel=TOC_3501& (last visited July 6, 2010).

17 *Id.*

18 *Id.*; Ref. Altman v. Minn. Dept. of Corr., 251 F.3d 1199 (7th Cir. 2001) (holding that conduct of correctional employees in silently reading their Bibles during a mandatory "diversity training" session regarding homosexual activity in the workplace involved First Amendment protected speech on a matter of public interest and concern).

19 *Id.*

20 See the discussion of Wheaton College in the floor debate on H.R. 3685, 153 Cong. Rec. 172, H13243 (2007).

21 H.R. 3685, 110th Cong. § 6 (as passed by House, Nov. 7, 2007), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=110_cong_bills&docid=f:h3685eh.txt.pdf.

22 *See* Amendments to H.R.3685, http://www.thomas.gov/cgi-bin/bdquery/L?d110:./temp/~bdaueoW:1[1-3]%28Amendments_For_H.R.3685%29&./temp/~bddKua (last visited July 6, 2010).

23 *Id.*

24 *Id.*

25 H.R.3685, Major Actions, http://www.thomas.gov/cgi-bin/bdquery/z?d110:HR03685:@@@R (last visited July 6, 2010).

26 *See generally* H.R. 3017, 111th Cong. (2009), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h3017ih.txt.pdf; H.R. 2981, 111th Cong. (2009), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:h2981ih.txt.pdf ; S. 1584, 111th Cong. (2009), *available at* http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=111_cong_bills&docid=f:s1584is.txt.pdf.

27 In all three bills, the religious exemption is contained in Section 6, and the provision excluding coverage based on marital status is contained in Section 8(b)(c).

28 *See, e.g.,* EEOC v. Presbyterian Ministries, Inc, 788 F. Supp. 1154 (W.D. Wash. 1992) (denominational retirement home held exempt); Saeemodarae v. Mercy Health Services, 456 F. Supp. 2d 1021 (N.D. Iowa 2006) (Catholic hospital exempt); McClure v. Salvation Army, 323 F. Supp. 1100 (N.D. Ga. 1971), *aff'd*, 460 F.2d 553 (5th Cir. 1972), *cert. denied*, 409 U.S. 896, *reh. denied*, 409 U.S. 1050 (Salvation Army held to be a religious corporation); Spencer v. World Vision, Inc. 570 F. Supp. 2d 1279 (W.D. Wash. 2008) (World Vision held exempt), *on appeal*, No. 08-35532 (9th Cir.); Gosche v. Calvert High School, 997 F. Supp. 867 (N.D. Ohio 1998), *aff'd*, 181 F.3d 101 (1999) (holding that a religious school could dismiss a music teacher for an adulterous relationship because a religious school could make adherence to the moral standards of the church a requirement of continued employment); LeBoon v. Lancaster Jewish Cmty. Ctr. Ass'n, 503 F.3d 217 (3rd Cir. 2007), *cert. denied*, 128 S. Ct. 2053 (2008) (Jewish community center exempt); Curay-Cramer v. Ursuline Academy, 344 F. Supp. 2d 923 (D. Del. 2004), *aff'd but criticized*, 450 F.3d 130 (3d Cir. 2006).

29 *Compare* Stately v. Indian Cmty. Sch. of Milwaukee, Inc., 351 F. Supp. 2d 858 (E.D. Wis. 2004) (A school based on traditional Indian spiritual and cultural principles raised doubt whether the district court had jurisdiction over a terminated teacher's Title VII claim where the school presented evidence that, although the school supported various religions, Native American religions were non-exclusive.), *with* Fike v. United Methodist Children's Home of Va., Inc., 547 F. Supp. 286 (E.D. Va. 1982), *aff'd on other grounds*, 709 F.2d 284 (4th Cir. 1983) (A Methodist children's home was a secular organization and not exempt; the direction given the day-to-day life for the children at the home was practically devoid of religious content.), Equal Employment Opportunity Comm'n v. Miss. Coll., 626 F.2d 477 (5th Cir. 1980), *cert. denied*, 453 U.S. 912 (1981) (Only the relationship between a church and its minister is exempt; the relationship between a religious educational institution and its faculty is not exempt.), *and* Vigars v. Valley Christian Ctr. of Dublin, 805 F. Supp. 802 (N.D. Cal. 1992) (A librarian's allegation that she was fired from a parochial school because of her out-of-wedlock pregnancy, if proven, would establish a Title VII violation; the fact that the school's dislike of pregnancy outside of marriage stemmed from religious belief did not automatically exempt the termination decision from Title VII scrutiny.).

30 *See Hearing on* "H.R. 3017, Employment Non-Discrimination Act of 2009," *Before the H. Comm. on Education and Labor*, 111th Cong. (2009) (statement of Craig L. Parshall, senior vice-president and general counsel, National Religious Broadcasters) (stressing this uncertainty), *available at* http://edlabor.house.gov/documents/111/pdf/testimony/20090923CraigParshallTestimony.pdf.

31 EEOC v. Kamehameha Schs./Bishop Estate, 990 F.2d 458, 464 (9th Cir. 1993) (amended on denial of rehearing), *cert. denied* 510 U.S. 963 (1993), contains a recitation of the legislative history of Sec. 2000e-2(e)(2).

32 *Compare* Myers v. Chestnut Hill Coll., No. 95-6244, 1996 WL 67612 (E.D. Pa., February 13, 1996) (citing Little v. Wuerl, 929 F.2d 944 (3d Cir. 1991)) (Defendant is a "private Catholic college for women . . . which is operated by the Catholic Order of the Sisters of St. Joseph," and thus, as a Catholic college operated by a particular religion or religious organization, association, or society, it clearly fell within the first part of the exemption.), *with* Siegel v. Truett-McConnell Coll., Inc., 13 F. Supp. 2d 1335 (N.D. Ga. 1994), *aff'd*, 73 F.3d 1108 (1995) ("In determining whether a college or school qualifies for the 2000e-2 exemption, all religious and secular characteristics must be weighed and considered. . . . Only those institutions with extremely close ties to organized religion will be covered."), Hall v. Baptist Mem'l Health Care Corp., 27 F. Supp. 2d 1029 (W.D. Tenn. 1998), *aff'd,* 215 F.3d 618 (2000) (A college of nursing and health science was a "religious educational institution," where it was founded by sectarian organizations, its avowed mission was to provide quality baccalaureate and continuing education in a Christian atmosphere, it hosted various religious functions, it had many ties to Baptist churches, and the purposes and programs of the college were permeated with a conviction to adhere to Christian principles, though the curriculum was primarily secular in nature.), *and* Killinger v. Samford Univ., 917 F. Supp. 773 (N.D. Ala. 1996), *aff'd*, 113 F.3d 196 (1997) (A university with a long history of Baptist connection was exempt despite a professor's contention that he was lured to the faculty by a promise that the university wanted to foster diversity and liberality in theological thought, and that the university committed itself to diversity by accepting a bequest conditioned upon university recruiting and maintaining faculty with diverse points of view in Protestant tradition.).

33 EEOC v. Kamehameha Schs./Bishop Estate, 990 F.2d at 466.

34 The statutory Title VII religious exemption is distinct from the "ministerial exception" that courts have created in response to the First Amendment's religious freedom protections.

35 Corp. of Presiding Bishop v. Amos, 483 U.S. 327, 336 (1987).

36 Title VII as originally enacted had the more limited exemption for ecclesiastical positions or duties, exempting only positions concerned with "religious activities." When Congress considered the Title again in 1972, the exemption was made institution-wide so that the government would not be required to interfere with the internal religious affairs of religious organizations. In the words of Sen. Sam Ervin (D-NC), "[T]his amendment is to take the political hands of Caesar off the institutions of God, where they have no place to be." 118 Cong. Rec. 4503 (Feb. 17, 1972) (*quoted and discussed in* Esbeck, Carlson-Thies & Sider, *supra* note 8, 26-28).

37 The following discussion leaves to the side the important matter of whether the current ENDA exemption does and should exempt for-profit religious organizations such as religious bookstores and retirement homes. The courts have been reluctant to consider for-profit entities as falling within the scope of the "religious organizations" entitled to the Title VII religious exemption, which means that religious businesses are not likely to be exempt from ENDA under the current language. *See* Julie Marie Baworowsky, Note, *From Public Square to Market Square: Theoretical Foundations of First and Fourteenth Amendment Protection of Corporate Religious Speech*, 83 Notre Dame L. Rev. 1713 (2008). The discussion also leaves aside the wisdom of adding to ENDA a bona fide occupational qualification provision ("BFOQ"). Title VII does have a BFOQ to accommodate instances when race or sex can be a bona fide occupational qualification, although the BFOQ is rarely used or upheld by the courts. *See, e.g.,* Int'l Union v. Johnson Controls, 499 U.S. 187, 201 (1991) (holding that an employer implementing a policy that excluded women who were pregnant or capable of bearing children from being placed in jobs involving lead exposure could not establish a bona fide occupational qualification) Trans World Airlines, Inc. v. Thurston, 469 U.S. 111, 122 (1985) (holding that a BFOQ defense was not available to the defendant airline under the ADEA when the airline denied only pilots aged sixty years or more the right automatically to train as flight engineers). Arguably there are instances when a homosexual orientation may be a BFOQ and, conversely, in which heterosexual convictions and conduct should be a BFOQ in a secular organization—such as a requirement that a marriage counselor who would serve orthodox Jewish or Muslim families, in order to gain their trust in sensitive marriage issues, should not be a person who engages in or promotes homosexual conduct.

38 *See* Bob Jones Univ. v. United States, 461 U.S. 574 (1983).

39 Similarly, in *Bob Jones*, the Supreme Court held that the IRS' interpretation of the tax code to deny two religious schools tax-exempt status because their religion-based admissions policies were racially discriminatory did not violate the schools' free exercise rights due to the government's compelling interest in "eradicating racial discrimination in education." *Id.* at 604.

40 494 U.S. 872 (1990); *cf.* Carl H. Esbeck, *When Accommodations for Religion Violate the Establishment Clause: Regularizing the Supreme Court's Analysis*, 110 W. Va. L. Rev. 359, 384-386 (2007) (arguing that *Smith* and its progeny should be applied narrowly so that they do not effectively "immunize from constitutional challenge intentional discrimination on account of religion").

41 42 U.S.C. § 2000bb. The Supreme Court struck down the application of the Religious Freedom Restoration Act ("RFRA") to the states in *City of Boerne v. Flores*, 521 U.S. 507 (1997) because it was beyond the scope of Congress' power to enforce Section 5 of the 14th Amendment and thus intruded upon the states' power to regulate the health and welfare of their citizens. However, the Court's decision only encompassed the application of the statute to the states, *id.*; therefore, it continues to apply to the actions of the federal government. Recently, for instance, the Department of Justice issued an opinion concluding that RFRA required a federal agency to exempt World Vision, a religious organization that had received a grant to perform charitable services for "at-risk youth," from the requirement attached to the grant that recipients not discriminate on the basis of religion with respect to its hiring practices. Application of the Religious Freedom Restoration Act to the Award of a Grant Pursuant to the Juvenile Justice and Delinquency Prevention Act, 31 Op. Off. Legal Counsel 1 (2007), *available at* http://www.justice.gov/olc/2007/worldvision.pdf.

42 Using language like that in RFRA, the statement might read that one of the purposes is "to strike a sensible balance between employment nondiscrimination requirements and religious freedom."

43 Possible language would be: "Nothing in this Act shall be construed to establish a compelling government interest relevant to a claim under the First Amendment of the U.S. Constitution or under 42 U.S.C. §2000bb *et. seq.* (the Religious Freedom Restoration Act of 1993)."

44 *See* Boy Scouts of Am. v. Dale, 530 U.S. 640 (2000) (holding that a New Jersey law requiring the Boy Scouts to admit openly homosexual members unconstitutionally restricted the Boy Scouts' right of expressive association). In response to this decision, state and municipal governments have retaliated against the Boy Scouts, refusing the organization access to public facilities, *see* Boy Scouts of Am. v. Till, 136 F. Supp. 2d 1295, 1297 (S.D. Fla. 2001) (describing a school board's termination of its agreement with the Boy Scouts allowing it after-hours use of its facilities), and revoking other privileges, *see* Evans v. City of Berkeley, 127 Cal. Rptr. 2d 696, 698 (Cal. Ct. App. 2002) (discussing Berkeley's revocation of the Boy Scouts' rent-free use of a public marina).

45 20 U.S.C. § 7905.

46 Discussed in Robin Fretwell Wilson, *Matters of Conscience: Lessons for Same-Sex Marriage from the Healthcare Context*, *in* Same-Sex Marriage and Religious Liberty: Emerging Conflicts 77, 85 (2008).

47 *Id*. at 86.

48 N.H. Rev. Stat. Ann. § 457:37 (2010).

49 Civil Marriage Act, 2005 S.C., ch. 33 (Can.).

50 A new clause could be added to the present Religious Exemption section, such as: "A religious employer's exemption from this Act shall not result in any action by any federal, state, or local government agency, which receives federal funds, to penalize or withhold licenses, permits, grants, tax-exempt status, or any other benefits from that employer, or prohibit the employer's participation in programs sponsored by that federal, state, or local government agency."

How the Proposed Amendments to the Organizational Sentencing Guidelines Will Affect Corporate Compliance and Ethics Programs

*By Michael H. Huneke**

On April 29, 2010, the U.S. Sentencing Commission ("Commission") submitted to Congress proposed amendments to, *inter alia*, the sentencing guidelines applicable to business organizations ("Organizational Guidelines") in Chapter 8 of the U.S. Sentencing Guidelines Manual ("U.S.S.G.").[1] The amendments, unless Congress acts to the contrary, will become effective on November 1, 2010.[2]

Because the Organizational Guidelines inform the design and implementation of business organizations' compliance and ethics programs and reporting structures, businesses should consider whether to change their existing compliance and ethics programs and structures in light of the proposed amendments. In particular, the Commission submitted to Congress an amendment that would allow an organization to receive credit for having an effective compliance and ethics program even if high-level personnel were involved in criminal conduct, but only if several conditions are met. These conditions include establishing a direct reporting line between those with operational responsibilities under the compliance and ethics plan and the board of directors or audit committee. Organizations that do not already have such a direct reporting line of authority will need to consider whether to change their reporting structure in order to secure credit for an effective compliance and ethics program, even if high-level personnel are involved in criminal conduct.

This article will provide a brief overview of the current organizational guidelines, summarize the amendments the Commission proposed to Congress and relevant debate surrounding each, summarize contemplated amendments that the Commission decided not to propose, and highlight some practical considerations in anticipation of the amendments.

I. Overview of the Current Organizational Guidelines

The Organizational Guidelines' purpose is to "provide just punishment, adequate deterrence, and incentives for organizations to maintain internal mechanisms for preventing, detecting, and reporting criminal conduct."[3] The Organizational Guidelines accordingly authorize courts to require guilty organizations to pay restitution, remedy past or prevent future harm caused by the offense, perform community service, and provide notice of the offense to victims.[4] To provide organizations with further incentive to prevent, detect, and report criminal conduct, the Organizational Guidelines allow courts to reduce an organization's "culpability score"[5] if the organization had "an effective compliance and ethics program" in place at the time of the offense. Separately, an organization can also receive varying levels of credit for reporting the criminal conduct to the government, fully cooperating with the government's investigation, or accepting responsibility for the criminal conduct.[6]

An organization cannot benefit from a pre-existing effective compliance and ethics program, however, if the organization, "after becoming aware of the offense, . . . unreasonably delayed reporting the offense to appropriate governmental authorities,"[7] or if the offense involved either "high-level personnel"[8] of the organization or individuals with oversight or operational responsibilities for compliance.[9] A rebuttable presumption that the organization did not have an effective compliance and ethics program exists for any organization whose "substantial authority personnel"[10] were involved in the criminal conduct and for small organizations (of less than 200 employees) whose high-level personnel were involved.[11]

The Organizational Guidelines set minimum standards for "effective" compliance and ethics programs and provide both general objectives and specific minimum requirements for such programs.[12]

Generally, a compliance and ethics program is "a program designed to prevent and detect criminal conduct."[13] To accomplish this end, an organization must design its program with two objectives in mind: "(1) exercise due diligence to prevent and detect criminal conduct; and (2) otherwise promote an organizational culture that encourages ethical conduct and a commitment to compliance with the law."[14] The Commission intended for the latter "cultural" requirement "to reflect the emphasis on ethical conduct and values incorporated into recent legislative and regulatory reforms, such as those provided by the [Sarbanes-Oxley] Act [of 2002]."[15]

Specifically, the Organizational Guidelines impose seven minimum requirements for an effective compliance and ethics program:

(1) The organization must establish "standards and procedures to prevent and detect criminal conduct";[16]

(2) The organization's "governing authority"[17] must exercise reasonable oversight over the program, identified "high-level personnel"[18] must have overall responsibility for the program, and identified individuals with adequate resources and authority, including direct access to the governing authority or an appropriate sub-group thereof, must have day-to-day operational responsibility for the program;[19]

(3) The organization must use reasonable efforts to exclude from "substantial authority personnel"[20] positions any persons with a history of conduct "inconsistent with an effective compliance and ethics program;"[21]

....

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(4) The organization must take reasonable steps to train and inform personnel regarding the program;[22]

(5) The organization must monitor, audit, and evaluate the effectiveness of its compliance and ethics program and provide a means for personnel to ask questions or report potential violations;[23]

(6) The organization must promote, enforce, and incentivize compliance with its compliance and ethics program, including appropriately disciplining violators;[24] and

(7) The organization must respond appropriately to detected criminal conduct and take reasonable steps to prevent further similar conduct, including modifying its compliance and ethics program.[25]

An effective compliance and ethics program must also be "reasonably designed, implemented, and enforced" to be "generally effective in preventing and detecting criminal conduct."[26] Importantly, this standard requires only a "reasonable," "generally effective" program, recognizing that employees or agents might commit criminal acts even under the most extensive compliance and ethics programs, and the Organizational Guidelines recognize that the offense for which the court is sentencing the organization cannot preclude the organization from receiving a lower culpability score for its program.[27] Were it otherwise, no organization could receive any benefit under the Organizational Guidelines for having an effective program.

Finally, an organization must periodically review its compliance and ethics program and "design, implement, or modify" aspects of the program that correspond to the seven specific requirements listed above to address any changes in the organization's risk of criminal conduct.[28]

Despite the ubiquity of public discussion regarding organizations' compliance obligations, many organizations have yet to adopt any compliance or ethics program. According to the Commission's 2009 Sourcebook for Federal Statistics, during the United States government's 2009 fiscal year ("FY 2009"), all ninety-six organizational defendants against whom the sentencing court imposed a fine and for whom it specified its reasons under the fine guidelines had no compliance program at all.[29] The consequences can be dire: according to the Commission, the average criminal fine across all organizational defendants who received a fine was more than $17 million in FY 2009.[30]

II. Amendments Proposed to Congress

In addition to several technical or conforming amendments, the Commission proposed several substantive amendments to the Organizational Guidelines.

A. Credit for an Effective Compliance and Ethics Program Even if High-Level Personnel Were Involved

Very few organizations have ever received credit under the Organizational Guidelines for having an effective compliance and ethics program. According to public testimony, since the government's 1995 fiscal year, only three organizations received a reduction in their culpability scores for having an effective compliance plan.[31] Public comment suggested that, at least anecdotally, the dearth of reductions in culpability scores for having an effective compliance and ethics plan was due to the fact that rarely would an organization be able to show a lack of involvement by "high-level personnel."[32]

On January 21, 2010, the Commission proposed an "issue for comment" that would allow an organization to receive credit for an effective compliance program even if "high-level personnel" were involved in the conduct, under certain conditions.[33] After receiving public comment and testimony, the Commission proposed to Congress an amendment based on this issue for comment. As proposed, the amendment provides that an organization may still get credit for an effective compliance and ethics program, notwithstanding high-level personnel's involvement in the criminal conduct, if:

> (i) the individual or individuals with operational responsibility for the compliance and ethics program . . . have direct reporting obligations to the governing authority or an appropriate subgroup thereof (e.g., an audit committee of the board of directors);
>
> (ii) the compliance and ethics program detected the offense before discovery outside the organization or before such discovery was reasonably likely;
>
> (iii) the organization promptly reported the offense to appropriate governmental authorities; and
>
> (iv) no individual with operational responsibility for the compliance and ethics program participated in, condoned, or was willfully ignorant of the offense.[34]

If Congress does not modify or reject this proposed amendment, organizations might have to change reporting structures in order to maintain their eligibility to receive the effective program reduction in their culpability scores. This restructuring might be difficult if, for example, an organization designed its current reporting structure to meet the requirements of the current Organizational Guidelines, which only require personnel with day-to-day operational responsibility to report periodically to the governing authority, or an appropriate subgroup thereof, and to have only direct "access" to the governing authority or a subgroup thereof.[35]

The amendments proposed to Congress include an application note defining the "direct reporting obligations" referenced in (i) above, in response to public comment criticizing the ambiguity of the phrase,[36] as:

> [A]n individual has "direct reporting obligations" to the governing authority or an appropriate subgroup thereof if the individual has express authority to communicate personally to the governing authority or appropriate subgroup thereof (A) promptly on any matter involving criminal conduct or potential criminal conduct, and (B) no less than annually on the implementation and effectiveness of the compliance and ethics program.[37]

The Commission intended for this proposed amendment to respond to the concerns that the current conditions on receiving credit for an effective compliance and ethics program are too restrictive "and that internal and external reporting of

criminal conduct could be better encouraged by providing an exception to [those conditions] in appropriate cases."[38] Additionally, the Commission explained that the proposed application note defining "direct reporting obligations" was in response "to public comment and testimony regarding the challenges operational compliance personnel may face when seeking to report criminal conduct to the governing authority of an organization and encourages compliance and ethics policies that provide operational compliance personnel with access to the governing authority when necessary."[39]

Despite this effort to increase the number of organizational defendants who might benefit from the effective compliance and ethics program credit, public criticism of many elements of the proposed amendment create doubt that the amendment will accomplish this objective. Several public comments criticized the prompt self-reporting requirement (iii), because it is redundant with another Organizational Guideline that rewards self-reporting (thereby potentially over-emphasizing self-reporting) and because the question of whether conduct was criminal is not always apparent, even after an internal investigation.[40] Additionally, public comment suggested that the discovery requirement (ii) is inconsistent with the Organizational Guidelines' acknowledgment that even an effective compliance and ethics program may not detect and prevent all criminal conduct and that the direct reporting requirement (i) fails to accommodate different reporting structures and organizational sizes.[41] Even the U.S. Department of Justice ("DOJ"), a strong supporter of requirements (ii) and (iii) above, expressed concern that the governing authority—even the audit committee—might not be responsive enough to accomplish effective reporting of criminal conduct, but the Commission declined to adopt the DOJ's proposed revision that would allow for direct reporting to either the organization's general counsel or the governing authority (or an appropriate subgroup of the latter).[42]

Organizations and their advisors should closely monitor any congressional debate regarding this proposed amendment because it appears that the Commission did not mollify many concerns raised in the public comments, in contrast to its responsiveness to concerns with the proposed amendment discussed below.

B. New Application Note Regarding an Organization's Response to the Discovery of Criminal Conduct

The amendments proposed to Congress include a new application note regarding an organization's response, under an effective compliance and ethics program, to the discovery of criminal conduct—the seventh minimum requirement for an effective compliance and ethics program. Currently, no application note addresses this particular requirement.[43] The Commission believes that the revised proposed amendments to the application note "may encourage organizations to take reasonable steps upon discovery of criminal conduct" and is "consistent with factors considered by enforcement agencies in evaluating organizational compliance and ethics practices."[44]

The application note, as proposed to Congress, stresses that an effective compliance and ethics program must address two specific issues upon discovery of criminal conduct. First, the organization must take "reasonable steps, as warranted under the circumstances, to remedy the harm resulting from the criminal conduct."[45] Such steps "may include, where appropriate," restitution, other forms of remediation, self-reporting, or cooperation with authorities.[46] As originally proposed, the amended application note stated that an organization "should take reasonable steps to provide restitution and otherwise remedy the harm resulting from the criminal conduct."[47] But after public comment included concerns about how the proposed application note might affect parallel or related civil litigation, the Commission adopted the more deferential, advisory language proposed to Congress.[48]

Second, the organization "should act appropriately to prevent further similar criminal conduct," including making any changes to its compliance and ethics program "necessary to ensure the program is effective.[49] The amendment initially included a suggestion that an organization "may take the additional step of retaining an independent monitor to ensure adequate assessment and implementation of [any such] modifications,"[50] but public comment raised the concern that, although technically precatory, such an express reference to monitors might over-encourage courts to impose outside monitors.[51] The Commission dropped the express reference to an independent monitor and only proposed to Congress a more general reference to the retention of an "outside professional advisor" for that purpose.[52]

The Commission's responsiveness to public criticism of the amended application note regarding discovered criminal conduct was exceeded in several instances, described below, where the Commission dropped contemplated amendments after critical public comment.

III. Amendments Dropped after Public Notice & Comment

The Commission proposed several amendments on January 21, 2010, that it ultimately did not propose to Congress. These contemplated amendments would have expressly required high-level and substantial authority personnel and employees to be aware of document retention policies and organizations to modify such policies as their compliance risks changed.[53] Public comment critical of such amendments generally argued that these amendments did not appear to be necessary to resolve any actual issues and were unrealistically over-burdensome for large organizations that might have numerous policies for different types of records.[54]

The Commission also dropped two controversial amendments to the Organizational Guidelines applicable to organizational probation. The first would have allowed courts to impose independent monitors as a condition of organizational probation, and this met with criticism from public comment for promoting the overuse of controversial independent monitors.[55] The second would have allowed unscheduled facilities inspections of organizations on probation, beyond the inspections of books and records and interviews of knowledgeable company personnel permitted under the current Organizational Guidelines.[56] Although enforcement agencies supported the latter amendment,[57] the Commission did not propose either amendment to Congress. The Commission did, however, propose amendments to

organizational probation that would eliminate a distinction in the existing Guidelines between the conditions of probation available to enforce a monetary penalty and those available for any other reason.[58] Under the amendment, all conditions of probation are available whenever probation is available.

IV. Practical Advice for Preparing a Response to the Proposed Amendments

The most controversial amendment proposed to Congress is the amendment that would remove the absolute bar to receiving effective compliance program credit if a high-level official was involved in the criminal conduct. Given the practical and bureaucratic challenges involved in changing any compliance function, organizations would be well-advised to decide, if they have not already, whether and how they will modify their compliance structures to secure the benefits of their compliance and ethics programs under the Organizational Guidelines against criminal conduct by high-level personnel.

More generally, compliance planning requires organizations to make judgment calls in light of experience and the best information available to them about their likely legal, business, and reputational risks, given the nature and location of their operations. Compliance planning also includes planning for misconduct to occur, given the inability of even the most efficient and comprehensive compliance programs to eliminate completely the risk of non-compliance. And compliance planning is not limited to compliance with the Organizational Guidelines; several other U.S. agencies have adopted their own requirements for effective compliance programs.[59] Organizations must be aware of which agencies' requirements apply to them.

Given the unpredictability of compliance challenges facing any business organization and the Organizational Guidelines' frequent reliance on vague reasonableness standards, it is important for a business organization to make informed, deliberate, and documented decisions when designing, implementing, assessing, or modifying its compliance and ethics program. Any decisions about compliance risks and the allocation of (often limited) compliance resources should be made under the assumption that someday the organization will need to defend its decisions before a skeptical regulator, prosecutor, or court. The Commission's proposed 2010 amendments to the Organizational Guidelines are, however, significant enough to justify the time and expense required to re-calibrate existing compliance programs.

Endnotes

1 Sentencing Guidelines for United States Courts, 75 Fed. Reg. 27,388, 27,394-27,395 (May 14, 2010). Unless otherwise noted, all references to the U.S.S.G. are to the Guidelines Manual and Appendices effective November 1, 2009. "Organizations" are legal persons other than individuals, 18 U.S.C. § 18 (2006), including "corporations, partnerships, associations, joint-stock companies, unions, trusts, pension funds, unincorporated organizations, governments and political subdivisions thereof, and non-profit organizations." U.S.S.G. § 8A1.1, app. n.1.

2 *See* 28 U.S.C. § 994(p) (2006).

3 U.S.S.G., Ch. 8, Introductory Commentary.

4 U.S.S.G. §§ 8B1.1, 8B1.2, 8B1.3, 8B1.4.

5 *See generally* U.S.S.G. §§ 8A1.2 (explaining how to calculate an organization's sentence and the relevance of the "culpability score"), 8C2.5 (explaining how to calculate a "culpability score").

6 U.S.S.G. § 8C2.5(f)(1), (g).

7 U.S.S.G. § 8C2.5(f)(2).

8 "'High-level personnel of the organization' means individuals who have substantial control over the organization or who have a substantial role in the making of policy within the organization. The term includes: a director; an executive officer; an individual in charge of a major business or functional unit of the organization, such as sales, administration, or finance; and an individual with a substantial ownership interest. . . ." U.S.S.G. § 8A1.2, app. n.3(b).

9 U.S.S.G. § 8C2.5(f)(3)(A).

10 "'Substantial authority personnel' means individuals who within the scope of their authority exercise a substantial measure of discretion in acting on behalf of an organization. The term includes high-level personnel of the organization, individuals who exercise substantial supervisory authority (e.g., a plant manager, a sales manager), and any other individuals who, although not a part of an organization's management, nevertheless exercise substantial discretion when acting within the scope of their authority (e.g., an individual with authority in an organization to negotiate or set price levels or an individual authorized to negotiate or approve significant contracts). Whether an individual falls within this category must be determined on a case-by-case basis." U.S.S.G. § 8A1.2, app. n.3(c).

11 U.S.S.G. § 8C2.5(f)(3)(B); § 8C2.5, app. n.1.

12 The current minimum standards became effective on November 1, 2004, and were the Commission's response to Congress's instruction in the Sarbanes-Oxley Act of 2002 to "review and amend, as appropriate," the Organizational Guidelines to ensure they "are sufficient to deter and punish organizational criminal misconduct." Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 805(a)(5), 116 Stat. 802 (2002) (codified as a note to 28 U.S.C. § 994); *see* U.S.S.G. Supp. app. C., amend. 673 (Nov. 1, 2004). Before November 1, 2004, the Organizational Guidelines allowed for a reduction in culpability score for organizations that adopted an "effective program to prevent and detect violations of law," the "hallmark" of which was the exercise of "due diligence in seeking to prevent and detect criminal conduct by [the organization's] employees and other agents." *See* U.S.S.G. § 8A1.2, app. n.3(k) (2003). In turn, the Organizational Guidelines provided seven "types of steps" as the minimum amount due diligence in an effective program: (1) "establish[ing] compliance standards and procedures to be followed by its employees and other agents that are reasonably capable of reducing the prospect of criminal conduct," (2) assigning to "[s]pecific individual(s) within high-level personnel of the organization . . . overall responsibility to oversee compliance with such standards and procedures," (3) "us[ing] due care not to delegate substantial discretionary authority to individuals whom the organization knew, or should have known through the exercise of due diligence, had a propensity to engage in illegal activities," (4) "tak[ing] steps to communicate effectively its standards and procedures to all employees and other agents, e.g., by requiring participation in training programs or by disseminating publications that explain in a practical manner what is required," (5) "tak[ing] reasonable steps to achieve compliance with its standards, e.g., by utilizing monitoring and auditing systems reasonably designed to detect criminal conduct by its employees and other agents and by having in place and publicizing a reporting system whereby employees and other agents could report criminal conduct by others within the organization without fear of retribution," (6) "consistently enforce[ing] [the standards] through appropriate disciplinary mechanisms, including, as appropriate, discipline of individuals responsible for the failure to detect an offense. . . .," and (7) "tak[ing] all reasonable steps to respond appropriately to [an] offense and to prevent further similar offenses—including any necessary modifications to its program to prevent and detect violations of law." *Id.* The Organizational Guidelines stated that the precise actions necessary would vary with the size of the organization, the likelihood of certain offenses given the nature of the organization's business, and the organization's prior history. *Id.*

13 U.S.S.G. § 8B2.1, app. n.1.

14 U.S.S.G. § 8B2.1(a).

15 U.S.S.G., app. C, amend. 673, Reason for Amendment.

16 U.S.S.G. § 8B2.1(b)(1).

17 Defined as "(A) the Board of Directors; or (B) if the organization does not have a Board of Directors, the highest-level governing body of the organization." U.S.S.G. § 8B2.1, app. n.1.

18 *See supra* note 8.

19 U.S.S.G. § 8B2.1(b)(2).

20 *See supra* note 10.

21 U.S.S.G. § 8B2.1(b)(3).

22 U.S.S.G. § 8B2.1(b)(4).

23 U.S.S.G. § 8B2.1(b)(5).

24 U.S.S.G. § 8B2.1(b)(6).

25 U.S.S.G. § 8B2.1(b)(7).

26 U.S.S.G. § 8B2.1(a).

27 U.S.S.G. § 8B2.1(a) ("The failure to prevent or detect the instant offense does not necessarily mean that the program is not generally effective in preventing and detecting criminal conduct.").

28 U.S.S.G. § 8B2.1(c).

29 U.S. Sentencing Comm'n, 2009 Sourcebook of Federal Sentencing Statistics, Table 54, http://www.ussc.gov/ANNRPT/2009/Table54.pdf (last visited May 16, 2010); see id. n.1 (explaining why the remaining 81 cases sentenced out of a total of 177 cases against organizational defendants did not include a fine).

30 United States Sentencing Comm'n, 2009 Sourcebook of Federal Sentencing Statistics, Table 52, http://www.ussc.gov/ANNRPT/2009/Table52.pdf (last visited May 16, 2010); *see id.* n.2 (noting that the Commission counted a fine imposed on multiple defendants jointly or severally for each defendant, likely resulting in overstatement of the average fines imposed).

31 David Debold, Chair, Practitioner's Advisory Group, Testimony Before the U.S. Sentencing Comm'n, at 4 (Mar. 17, 2010) ("PAG Letter").

32 *See, e.g., id.* at 4; Letter from Susan Hackett, Sr. Vice President & General Counsel, Association of Corporate Counsel, to the U.S. Sentencing Comm'n at 8 (Mar. 17, 2010) ("ACC Letter").

33 75 Fed. Reg. 3,535 ("(A) the individual(s) with operational responsibility for compliance in the organization have direct reporting authority to the board level (e.g. an audit committee of the board); (B) the compliance program was successful in detecting the offense prior to discovery or reasonable likelihood of discovery outside of the organization; and (C) the organization promptly reported the violation to the appropriate authorities[.]").

34 75 Fed. Reg. 27,394.

35 U.S.S.G. § 8B2.1(b)(2)(C).

36 ACC Letter at 8-9.

37 75 Fed. Reg. 27,394.

38 75 Fed. Reg. 27,395.

39 *Id.*

40 *See, e.g.,* PAG Letter at 5-6; ACC Letter at 9-10; Written Statement of Cynthia Hujar Orr on behalf of the Nat'l Ass'n of Criminal Def. Lawyers at 5-6, 8, Mar. 17, 2010 ("NACDL Statement").

41 *See* NACDL Statement at 8.

42 *See* Letter from Jonathan J. Wroblewski, Director, Office of Policy and Legislation, to the Hon. William K. Sessions III, at 20-21 (Mar. 22, 2010) ("DOJ Letter").

43 *See* U.S.S.G. § 8B2.1, cmt.

44 75 Fed. Reg. 27,395.

45 75 Fed. Reg. 27,394.

46 75 Fed. Reg. 27,394.

47 Sentencing Guidelines for United States Courts, 75 Fed. Reg. 3,525, 3,535 (Jan. 21, 2010).

48 *See, e.g.,* NACDL Statement at 5-6.

49 75 Fed. Reg. 27,394.

50 75 Fed. Reg. 3,535.

51 *See, e.g.,* ACC Letter at 4 ("[T]he Guidelines should not suggest that appointment of a monitor to address remediation going forward is some kind of common best practice that a company would choose, nor should it be a necessary consideration as a show of good faith in cases where such an extreme option is not warranted.").

52 75 Fed. Reg. 27,394.

53 75 Fed. Reg. 3,535.

54 *See, e.g.,* PAG Letter at 3-4; ACC Letter at 4-5, 7; NACDL Statement at 7.

55 75 Fed. Reg. 3,535; PAG Letter at 1-2; ACC Letter at 5-7; NACDL Statement at 6-8.

56 75 Fed. Reg. 3,535.

57 *See* DOJ Letter at 18-19; Letter from Cynthia Giles, Assistant Administrator, Environmental Protection Agency, to Michael Courlander, United States Sentencing Comm'n, at 1 (Mar. 22, 2010); Letter from Lois J. Schiffer, General Counsel, National Oceanic and Atmospheric Administration, at 1 (Mar. 22, 2010).

58 75 Fed. Reg. 27,394-27,395.

59 *See, e.g.,* U.S. Attorney's Manual, Principles of Federal Prosecution of Business Organizations, 9-28.800 (the U.S. Department of Justice's Corporate Compliance Program); Final Rule: Compliance Programs of Investment Companies and Investment Advisors, Exchange Act Release Nos. IA-2204, IC-26299, File No. S7-03-03 (effective Feb. 5, 2004); Contractor Code of Business Ethics and Conduct, Federal Acquisition Regulations 52.203-13 (Apr. 2010); Dep't of Health & Human Servs., Publication of the OIG Compliance Program Guidance for Hospitals, 63 Fed. Reg. 8,987 (Feb. 23, 1998).

NOL Pill Reloaded: *Selectica, Inc. v. Versata Enterprises, Inc.*

*By Robert T. Miller**

The poison pill is the paradigm anti-takeover device. As everyone involved in corporate law knows, under the terms of a typical pill, if a hostile acquirer purchases more than a designated percentage (usually fifteen percent) of the target company's stock without the board's consent, then all the other shareholders of the target receive new shares of the target's stock, thus massively diluting the acquirer's stake in the target. The acquirer thus fails to obtain voting control of the target and loses a significant part of its investment as the dilution transfers wealth from it to the other target shareholders.[1] Although the mechanics of a typical poison pill are much more complex than such a summary indicates,[2] the general effect of the pill is well-known: potential acquirers facing a target protected by a pill do *not* trigger the pill. They either negotiate with the target board to reach a friendly deal, or, failing that, they couple a tender offer conditional on the withdrawal of the target's pill with a proxy contest to replace the target's board with nominees pledged to complete a deal with the acquirer. In practice, although pills thus afford target boards significant time and leverage to negotiate with acquirers, a determined acquirer willing to pay a price that the target shareholders find attractive and bear the additional costs and delays involved in waging a proxy contest can be reasonably certain of eventually obtaining control of the company. Despite continuing criticism from academics and shareholder organizations like RiskMetrics, poison pills are still widely used by public companies in the United States, and the Delaware Supreme Court regards the legal validity of conventional poison pills as settled law.[3]

The poison pill can also be used for a quite different purpose, however—namely, to protect a company's net operating losses. This requires some background explanation.

Under applicable provisions of the Internal Revenue Code, when a company experiences a loss because its expenses exceed its income, it generally becomes entitled to use the loss to shelter future income from taxation.[4] Such net operating losses (NOLs) can generally be carried forward for twenty years, and so NOLs can be a valuable asset, lowering the company's tax liability and increasing its cash flow. NOLs are a contingent asset, however, because they have value only if the company has profits to shelter with them. If they are unused at the end of their twenty-year life, they expire and provide no value to the company. In general, only companies that have been consistently *unprofitable* over several years accumulate large quantities of NOLs. Valuing these NOLs is thus very difficult, for the question becomes whether a company that has consistently lost money for a considerable period will be able to generate profits in the future and, if so, how great will those profits be.

An obvious strategy for a money-losing company with accumulated NOLs would be to sell itself to a profitable acquirer that could then use the NOLs to shelter the income from its own profitable operations. Precisely to prevent such tax-driven transactions, Section 382 of the Internal Revenue Code severely limits the use of NOLs following an "ownership change." The definition of "ownership change," not surprisingly, is very complex, but the basic idea is that a company experiences an ownership change under Section 382 if more than fifty percent of its shares change hands within a three-year period, counting for such purposes only those shares in the hands of shareholders holding more than five percent of the company's shares. A straightforward acquisition of the company by another entity would, therefore, generally result in an "ownership change." That said, there may be certain kinds of strategic transactions in which the value of NOLs can be preserved. Hence, at least for certain counterparties, a target company's NOLs may be a source of value in a potential business combination.

For our purposes, however, the important point is that under Section 382, even relatively small changes in share ownership by the company's major shareholders can, at least by their aggregate effect, cause an ownership change. Hence, a company with a significant amount of NOLs that it wishes to protect against an unintended ownership change may well want to prevent parties owning less than five percent of the company's stock from becoming five-percent shareholders and want to prevent existing five-percent shareholders from increasing their stakes in the company. We thus come back to the relevance of a poison pill. A pill with a five-percent (or slightly lower) trigger will deter the kinds of transactions that could imperil the company's NOLs.

So-called NOL pills are thus in common use among companies with significant amounts of NOLs. Mechanically, they work substantially like conventional poison pills. They have, however, at least two important differences. First, if honestly adopted by the board to preserve the company's NOLs, an NOL pill will have a substantial anti-takeover effect even though the board may not in any way intend such an effect. The effect will be *foreseen*, but not *intended*. Second, by setting the triggering threshold at five percent (or slightly lower)—and thus well below that used in the typical pill—NOL pills have a significantly greater anti-takeover effect than conventional pills. Such pills are thus rather anomalous: not intended to deter takeovers, they in fact do deter takeovers even more than conventional poison pills. Nevertheless, because of their value in protecting NOLs, many public companies with significant NOLs have adopted them, and RiskMetrics has announced that in making recommendations to shareholders it will consider NOL pills on a case-by-case basis, taking account of such factors as the triggering threshold, the value of the NOLs, the term of the pill, and any sunset or similar features.[5]

In this context, it may seem fairly clear that, at least in general, NOL pills would be legal under Delaware law. This proposition was tested in the Delaware Court of Chancery (Vice Chancellor Noble) in *Selectica, Inc. v. Versata Enterprises, Inc*.[6] Under facts quite favorable to the target company, the Court

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of Chancery upheld the NOL pill in all respects, not only as to its adoption but also as to its implementation when triggered *and* its re-adoption after implementation. *Selectica* is thus the first case in the modern era in which a potential acquirer has triggered a pill and suffered the attendant dilution. The holding of the case, however, has relatively limited precedential value other than in connection with NOL pills, not only because NOL pills are always significantly different from typical pills but also because of facts peculiar to the case highly favorable to the target company. In this brief article, I shall (a) summarize the key facts in the case, (b) describe Vice Chancellor Noble's straightforward application of the *Unocal* doctrine[7] to uphold the NOL pill, and then (c) make some observations about the implications of the case for Delaware take-over law generally. I note in addition that an appeal in the case is currently before the Delaware Supreme Court. The conclusions expressed here are, therefore, merely tentative, pending the decision of that court.

I. Facts in Selectica v. Versata Enterprises

Selectica, Inc. (Selectica) is a Delaware corporation and micro-cap company whose common shares trade on the Nasdaq Global Market, and it is in the business of providing enterprise software solutions for contract management and sales configuration systems.[8] Since becoming a public company in 2000, Selectica has never had an annual profit and had thus accumulated approximately $160 million in NOLs.[9] At the time of the relevant events, its market capitalization was only about $23 million, and by its own admission its value consisted primarily of its cash reserves, its intellectual property, its customer base, and its NOLs.[10]

Trilogy, Inc. (Trilogy) is a private company and a competitor of Selectica, and Versata Enterprises, Inc. (Versata) is a subsidiary of Trilogy. Even prior to the events in the case, Trilogy and Selectica had a contentious relationship. In particular, over several years leading up to the events at issue in the case, Trilogy had successfully sued Selectica for patent infringement, securing a $7.5 million judgment; had repeatedly offered to acquire the company and been rebuffed; and had called attention to the fact that Selectica had back-dated certain stock option grants,[11] with the result that the company's chief executive officer, who had been its chief financial officer at the time of the backdating, resigned.[12] In addition, Trilogy had again sued Selectica for patent infringement, but this time the suit was settled with Selectica agreeing to pay Trilogy $10 million immediately and another $7.5 million over time.[13] Trilogy was thus a major creditor of Selectica. Although Trilogy had owned a significant number of Selectica shares at various times prior to the events in the case, after the settlement of this last dispute between the companies, Trilogy sold off all of its holdings in the company.[14]

In July of 2008, with the company still losing money, the Selectica board decided that the company needed to change course, and it terminated the chief executive officer and eliminated a number of other senior management positions in its key sales configuration business.[15] After receiving several unsolicited acquisition proposals in the course of a few weeks,[16] the board announced that it was exploring strategic alternatives and engaging a financial advisor to assist it in so doing.[17] Also in July of 2008, Trilogy offered to acquire the company, either by purchasing all of Selectica's sales configuration assets in exchange for cancelling the $7.1 million debt Selectica still owed Trilogy, or else by purchasing all of Selectica's assets for the cancellation of the same debt plus $6 million in cash.[18] Trilogy indicated that it was not interested in Selectica's NOLs and that, in both cases, Selectica's NOLs would remain behind with the historic Selectica entity so that they could be utilized in a subsequent transaction by that entity.[19] The Selectica board rejected both of these proposals.[20]

In October of 2008, Selectica's financial advisor began actively canvassing the market.[21] About the same time, Trilogy made another proposal to acquire all of Selectica's assets, this time for $10 million in cash plus the cancellation of debt, but the Selectica board rejected this proposal as well.[22] Although Selectica invited Trilogy to participate in the sales process it was conducting,[23] Trilogy declined to sign the non-disclosure agreement that Selectica was requiring of all participants in its process.[24] Also, unknown to the Selectica board, Trilogy began making open-market purchases of Selectica stock.[25] Meanwhile, Selectica's sales process continued, with several parties showing varying degrees of interest, many of them apparently quite serious.[26]

On November 10, Trilogy informed Selectica that it had accumulated more than 5 percent of Selectica's common stock and that it would shortly be filing a Schedule 13D with the Securities and Exchange Commission. A representative of Trilogy explained to a representative of Selectica that Trilogy was accumulating Selectica shares because it believed that Selectica "should work quickly to preserve whatever shareholder value remained and [Trilogy was] interested in seeing this process that [Selectica] announced . . . accelerate."[27] Soon thereafter, Trilogy purchased additional shares representing an additional one percent of the Selectica common stock, bringing its total stake to just over six percent.[28]

The Selectica board then inquired of its tax and other advisors about the potential effects on Selectica's NOLs of Trilogy's crossing the five-percent threshold.[29] Its advisors concluded that, because of other transactions by other shareholders in the past, after Trilogy's recent purchases, Selectica had already experienced a forty-percent change in ownership for Section 382 purposes, and thus if there were another ten-percent change, the company would undergo an ownership change within the meaning of Section 382 and the value of the company's NOLs would be impaired.[30] After extensive consultation with its advisors, the board unanimously resolved to amend its existing shareholder rights plan, which had a conventional fifteen-percent trigger, in order to reduce the trigger to 4.99 percent. The amendments to the plan also grandfathered existing five-percent shareholders, including Trilogy.[31] The board simultaneously established a committee of independent directors to review the rights agreement periodically, including the triggering percentage, and to determine whether the agreement continued to be in the best interests of the company.[32]

Just days later, Trilogy sent Selectica a letter asserting that Selectica had violated the settlement agreement from

their prior dispute and seeking a meeting to discuss the purported breach.[33] At trial, Selectica contended that Trilogy then threatened to trigger Selectica's NOL pill unless Selectica agreed to Trilogy's efforts to extract additional money from the company.[34] Although Vice Chancellor Noble did not expressly say whether he credited this contention, it appears that he did.[35] On December 18 and 19, Trilogy purchased additional Selectica shares, bringing its total ownership to 6.7 percent and thus becoming an "Acquiring Person" under Selectica's NOL pill.[36] Trilogy's controlling shareholder would later testify that in intentionally triggering Selectica's pill, Trilogy was trying to "bring accountability" to the Selectica board and "expose" what he characterized as its "illegal behavior" in adopting a pill with such a low trigger.[37] Soon thereafter, a Trilogy representative proposed that Selectica repurchase all of Trilogy's stock in Selectica, accelerate the repayment of the debt owed to Trilogy, make certain other commercial concessions, and pay Trilogy $5 million in cash to settle all outstanding issues between the parties.[38] Trilogy's representative also indicated that Trilogy had triggered the NOL pill "to get [Selectica's] attention" and "force the [Selectica] board to make a decision."[39]

Under the terms of the NOL pill, the Selectica board had ten days to determine whether a party triggering the pill would not endanger the availability to the company of the NOLs. If it made such a determination, the board could declare that party an exempt person, and the pill would not go into effect. If it failed to make such a determination, the board would have two options.[40] Either, it could implement the pill by exchanging each outstanding right for one newly issued share of Selectica common stock (the Exchange) or else allow the rights to "flip-in," in which case each right would become an exercisable option to purchase $36 worth of newly-issued common stock at a price of $18 per right.[41] During the ten-day period, Selectica repeatedly attempted to negotiate a standstill agreement with Trilogy but was rebuffed.[42]

Also during this ten-day period, the board met repeatedly with its advisors. Its tax advisors discussed the amount of its NOLs, the risk of a Section 382 ownership change, and the likely tax effects of implementing the pill through the Exchange or through the flip-in.[43] Its financial advisors discussed the value of the NOLs in connection with various potential strategic transactions the company was pursuing and reiterated its opinion that an ownership change would reduce the value of the company.[44] The board also discussed Trilogy's demands and found that they were "highly unreasonable."[45] The board concluded that Trilogy's actions were "very harmful to [Selectica]" and that implementing the NOL pill was "reasonable in relation to the threat imposed by Trilogy."[46] After Trilogy once again refused to enter a standstill agreement, the board determined that the pill should be implemented and that employing the Exchange was preferable to allowing the pill to flip-in.[47] On January 2, the board delegated authority to the committee of independent directors to determine whether the pill should be implemented; whether, if implemented, the company should employ the Exchange option or the flip-in; and whether the company should declare a new dividend of rights reloading the pill.[48] The committee then met and received presentations from the company's advisors reiterating that the NOLs were a valuable corporate asset, that the NOL pill would help protect the NOLs, and that Trilogy's actions posed a threat to the NOLs.[49] The committee then concluded that Trilogy should not be deemed an exempt person under the pill, that the company should exercise the Exchange option to exchange one common share for each right, and that the company should declare a new dividend of rights substantially similar to the rights being redeemed.[50] In this way, the Exchange doubled the number of shares outstanding owned by the company's shareholders other than Trilogy, thus reducing Trilogy's interest in the company from about 6.7 percent to about 3.3 percent.[51]

Selectica then sued Versata and Trilogy, seeking a declarative judgment that its actions in adopting the NOL pill, implementing it through the Exchange option, and then reloading the pill were legal.[52] Trilogy counterclaimed, alleging that all these actions were invalid, void, and unenforceable and seeking monetary damages for alleged breaches of fiduciary duty by members of Selectica's board of directors, as well as orders enjoining or rescinding the Exchange and requiring Selectica to redeem the rights dividended to reload the pill.[53]

II. Vice Chancellor Noble's Legal Analysis

After noting that Delaware law has long recognized the validity of conventional poison pills,[54] Vice Chancellor Noble reviewed under *Unocal*[55] the Selectica board's actions in connection with the NOL pill. That is, he inquired whether the directors had shown that (a) "they had reasonable grounds for believing that a danger to corporate policy and effectiveness existed,"[56] and (b) their "defensive response was reasonable in relation to the threat posed."[57] Interpreting *Unocal* in accordance with *Unitrin*,[58] he noted that "a defensive measure is disproportionate (i.e., unreasonable) if it is either coercive or preclusive" or else otherwise disproportionate to the threat posed.[59]

As to the first part of the *Unocal* inquiry, in determining whether the Selectica board had reasonable grounds for concluding that Trilogy's actions posed a threat to the corporation, the court understood this question as turning on whether the NOLs had value—i.e., whether they were a legitimate asset of the company. Here, Vice Chancellor Noble first noted that the value of NOLs depends on the company's having income in the future that the NOLs can shelter and thus, since the future profitability of the company is unknowable, the "NOL value is inherently unknowable ex ante."[60] Nevertheless, "a board may properly conclude that the company's NOLs are worth protecting where it does so reasonably and in reliance on expert advice,"[61] and so the court concluded that "the protection of company NOLs may be an appropriate corporate policy meriting a defensive response when threatened."[62] Indeed, observing that NOL pills, in contradistinction from conventional pills, are aimed at protecting a particular corporate asset and only incidentally at deterring takeover efforts, the Vice Chancellor even stated that "the protection of corporate assets against an outside threat is arguably a more important concern of the Board than restricting who the owners of the Company might be."[63]

As to the second part of the *Unocal* inquiry, in determining whether the Selectica board's response to the perceived threat

was reasonable, Vice Chancellor Noble followed the usual *Unocal-Unitrin* inquiry by first determining whether the NOL pill was preclusive or coercive.[64] Since Trilogy did not allege that Selectica's NOL pill was coercive,[65] this inquiry reduced to whether the pill was preclusive—that is, whether it "makes a bidder's ability to wage a successful proxy contest and gain control either 'mathematically impossible' or 'realistically unattainable.'"[66]

On this issue, the parties produced conflicting expert testimony. Professor Allen Ferrell (for Trilogy) argued that the low (4.99 percent) trigger of an NOL pill, coupled as it was in Selectica's case with a classified board, made winning a proxy contest realistically unattainable because the effort would have to be sustained through two annual elections of directors and the low ownership interest of the potential acquirer would make the potential acquirer appear less credible in the eyes of other shareholders and exacerbate the free-rider problem[67] faced by all insurgent investors fielding slates of candidates for the board.[68] Professor Ferrell further noted that, as of the time of the case, there had been no instance of a dissident shareholder with less than a five-percent stake successfully obtaining control of a micro-cap company with a classified board.[69] On the other hand, Peter C. Harkin of the D.F. King & Co. proxy solicitation firm (for Selectica) identified fifteen proxy contests at microcap companies in which the challenger held a less than 4.99 percent stake, and among these the challenger successfully obtained board seats in ten, including five in which the target company had a classified board,[70] though in none of these had the insurgent gained control of the board. Furthermore, although Trilogy's expert testified that an NOL pill coupled with a classified board "has a substantially preclusive effect," he nevertheless had to admit that it was "not 100 percent preclusive" and that there remained a "theoretical possibility"[71] of an acquirer winning a proxy contest. In the end, therefore, Vice Chancellor Noble held that Selectica's NOL pill, even coupled with its classified board, was not preclusive within the meaning of *Unitrin*. "To find a measure preclusive . . . the measure must render a successful proxy contest a near impossibility or else utterly moot, given the specific facts at hand."[72]

The Vice Chancellor then turned to the reasonableness of the NOL pill in relation to the threat posed. As to the adoption of the NOL pill, the Vice Chancellor observed that "Trilogy . . . failed to suggest any meaningfully different approach that the [Selectica] Board could have taken . . . to avoid the seemingly imminent impairment of Selectica's NOLs by Trilogy."[73] As to Selectica's actions after Trilogy had chewed through the pill, the court noted that Selectica repeatedly sought a standstill agreement with Trilogy and was rebuffed,[74] and that implementing the pill through the Exchange rather than the flip-in "was a more proportionate response" that caused Trilogy to "experience[] less dilution in its position than a poison pill is traditionally designed to achieve."[75] Finally, as to reloading the NOL pill by declaring a new dividend of rights, since, after the Exchange, Trilogy could have purchased additional shares in order to cause Selectica to suffer a Section 382 ownership change absent additional action by Selectica, "the implementation of the Reloaded NOL Pill was a similarly reasonable response in the context of Selectica's other defensive measures."[76]

The court concluded that "the combination of the NOL Pill, the Exchange, and the Reloaded NOL Pill was a proportionate response to the threatened loss of Selectica's NOLs."

III. Observations on the Implications of the Case

Any definitive interpretation of the *Selectica* case must await the opinion of the Delaware Supreme Court in the pending appeal, but subject to that qualification, I think we can draw several conclusions. First and foremost, the *Selectica* case stands for the proposition that NOL pills, like conventional poison pills, are legal in Delaware—a result that surprised probably no one.

That said, the inquiry involved in the case was a *Unocal* inquiry—that is, one concerning the reasonableness of the board's actions, and so one dependent on the totality of the facts and the circumstances. In *Selectica*, those facts and circumstances inclined strongly in favor of the target company. For, not only did the Selectica board use impeccably good procedure in deciding to adopt, implement, and reload its NOL pill, but the Vice Chancellor apparently also concluded that Trilogy was a bad actor. Although this is not perfectly explicit in his findings of fact, at the very end of the opinion the Vice Chancellor is brutally clear about his understanding of Trilogy and its motives. He writes that "the record demonstrates that a longtime competitor sought to employ the shareholder franchise intentionally to impair corporate assets, or else to coerce the Company into meeting certain business demands under the threat of such impairment."[77] The picture of Trilogy that emerges from the opinion is that of a predatory company that was interested primarily in exacting value from Selectica, preferably in the form a cash payment and other commercial concessions, and was willing to impair Selectica's NOLs to do so at a time when Selectica was shopping itself in large part on the strength of those NOLs. Trilogy appears, in other words, to be a corporate extortion artist. If this is really what happened, then it is easy to see how Selectica's adopting, implementing, and reloading the pill were emphatically in the best interest of Selectica and its shareholders.

It is worth contrasting this scenario with another quite different one. Imagine that a target company is protected by an NOL pill even though the company is currently profitable, and its NOLs, though valuable, are but a small fraction of the value of the company. Imagine further that a potential acquirer has made a seemingly attractive proposal to the board and been summarily rebuffed. The acquirer then launches an all-shares, all-cash tender offer at an even higher price and couples that offer with a proxy contest. Even holding a stake in the target below the NOL pill threshold, a well-monied and determined acquirer could probably prevail in such circumstances.[78] If, however, its small position in the company was hindering its take-over efforts, it is hard to believe the holding in *Selectica* would have much weight in the mind of a Delaware chancellor or vice chancellor considering a *Unocal* challenge to the target's pill. Indeed, in such circumstances, it would not escape the court's notice that, while the putative purpose of the pill is to protect the company's NOL assets, if the offer is successful the only party harmed by the resulting Section 382 ownership

change would be the acquirer itself as the new owner of the company.

The contrast between this scenario and the facts in *Versata* highlights again the key point that an NOL pill honestly adopted to protect NOLs is not exactly an anti-takeover device. That is, although such a pill has a strong anti-takeover effect, the board in adopting it need have no *intention* to limit takeover attempts at all; if the board really is acting solely to protect the company's NOLs, then the anti-takeover effect is a foreseen but unintended byproduct of such protection. This seems to have been the case in *Selectica*, and so this fact too significantly undercuts the precedential value of the case for future cases that really do concern takeovers.

There is one respect, however, in which *Selectica* may be relevant to more conventional takeover scenarios, and that concerns the reloading of the poison pill. Even with a conventional pill, the board's right to reload the pill after it is triggered and implemented is essential to its functioning. For example, imagine a company with 100 million shares outstanding trading at $10 per share (and thus a market capitalization of $1 billion) protected by a conventional fifteen-percent pill, and imagine further that a raider, rebuffed by the board, decides to acquire the company by chewing through the pill. Conventional wisdom notwithstanding, if the target's pill is not reloadable, this could well be a financially viable strategy for the raider. For instance, the raider could close on a tender offer for fifteen million shares of the target—just enough to trigger the pill—spending, say, $170 million (a 13.3 percent premium to market). If the pill then flips-in, just how much the raider will be diluted will depend on the details of the pill, but the raider cannot be diluted below zero, and so its financial loss at flip-in is necessarily less than its total investment of $170 million. If the company's board cannot reload the pill, the raider could then launch a second tender offer to acquire the rest of the company, which had a pre-deal market capitalization of $1 billion, at a twenty-percent premium. In the absence of a pill, this offer would likely succeed, and if it does, the raider will have spent about $1.37 billion for the company.[79] In effect, the raider will have paid a thirty-seven-percent premium for the target, which would hardly be extraordinary. To stop the raider from gaining control in this way, the target board would have to be able to reload the pill. The lesson, implicit in the *Selectica* case, is that the deterrent power of a poison pill ultimately depends on whether the board may reload it after it is triggered and implemented. If the pill is valid, then reloading the pill after it has been triggered should generally be valid as well. *Versata* so held for NOL pills. Assuming that this key aspect of the Chancery Court's opinion is upheld on appeal, then, when and if the time comes, Delaware courts will likely hold the same for conventional pills as well.

Endnotes

1 *See generally* Stephen M. Bainbridge, Corporation Law and Economics 680-690 (2002) (describing poison pills); Ronald J. Gilson & Bernard S. Black, The Law and Finance of Corporate Acquisitions 740-748 (1995) (same); The Law and Finance of Corporate Acquisitions, 2003-2004 Supplement 58-95 (2003) (reproducing large portions of the typical poison pill recommended by Wachtell, Lipton, Rosen & Katz).

2 *See generally* William J. Carney & Leonard A. Silverstein, *The Illusory Protection of Poison Pills*, 78 Notre Dame L. Rev. 179 (2003).

3 Leonard Loventhal Account v. Hilton Hotels Corp., 780 A.2d 245, 248 (Del. 2001) (holding on *stare decisis* grounds that it "is settled Delaware law that a corporation chartered under the laws of this State may adopt shareholder rights plans").

4 NOLs may also be carried back for two years to shelter past income from taxation.

5 RiskMetrics Group, 2010 U.S. Proxy Voting Guidelines Summary 26 (Dec. 31, 2009, updated Feb. 25, 2010), *available at* http://www.riskmetrics.com/sites/default/files/RMG_2010_US_SummaryGuidelines20100225.pdf.

6 Selectica, Inc. v. Versata Enterprises, Inc., 2010 WL 703062 (Del.Ch.).

7 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

8 *Selectica*, 2010 WL 703062 at *2.

9 *Id.*

10 *Id.*

11 *Id.*

12 *Id.* at *2 n.14.

13 *Id.* at *2.

14 *Id.* at *2 n. 16.

15 *Id.* at *4.

16 *Id.* at *5.

17 *Id.*

18 *Id.*

19 *Id. But see also id.* n.43, indicating that at some times in the past Trilogy had studied Selectica's NOLs and their potential value.

20 *Id.* at *5.

21 *Id.*

22 *Id.*

23 *Id.*

24 *Id.* It is unclear from Vice Chancellor Noble's opinion whether this was a simple confidentiality agreement related to the non-public information about the company that the company was supplying to potential bidders or whether the agreement was more extensive. In any case, it seems that other potential bidders were willing to sign the agreement, which raises a suspicion that Trilogy's declining to do so was perhaps pretextual.

25 *Id.*

26 Several months later, in February of 2009, there would be at least six parties that had come forward with letters of intent and that were actively conducting due diligence on the company. *Id.* at *5.

27 *Id.* at *5.

28 *Id.*

29 *Id.* at *6.

30 *Id.*

31 *Id.* at *7.

32 *Id.*

33 *Id.*

34 *Id.*

35 *See id.* at *23, where Vice Chancellor Noble states that "the record demonstrates that [Trilogy] sought to employ the shareholder franchise intentionally to impair corporate assets, or else to coerce [Selectica] into meeting certain business demands under the threat of such impairment."

36 *Id.* at *8.

37 *Id.*

38 *Id.*

39 *Id.*

40 *Id.*

41 *Id.* Presumably because the Selectica board ultimately decided to exercise the Exchange and not allow the pill to flip-in, the Vice Chancellor does not note how radical a flip-in event would have been. Recall that, at the time, Selectica's market capitalization was about $23 million, and it had about thirty-two million shares outstanding. If the rights flipped-in, then each of about 29,856,000 rights would become exercisable. To exercise these rights, their holders would need to pay into the company, in the aggregate, about $537,408,000, a sum about 23.4 times the current market capitalization of the company. The company would then issue to the former holders of the rights participating preferred shares essentially equivalent to about 1.822 billion common shares, thus effectively reducing Trilogy's interest in the company well below one percent. Of course, whether the company's shareholders could finance the exercise of their rights, and what the market would make of a consistently unprofitable microcap company suddenly sitting on cash reserve in excess of half a billion dollars is anyone's guess. Such considerations very likely figured into the Selectica board's decision to exchange the rights one-for-one for new shares of Selectica common stock rather than allowing them to flip-in. In addition, the flip-in event might itself have triggered a Section 382 ownership change. *See id.* at *9.

42 *Id.*

43 *Id.*

44 *Id.*

45 *Id.*

46 *Id.*

47 *Id.*

48 *Id.* at *10.

49 *Id.*

50 *Id.* at *11.

51 *Id.*

52 *Id.*

53 *Id.*

54 *See id.* at *12 (citing Moran v. Household Int'l, Inc., 500 A.2d 1346 (Del. 1985); Leonard Loventhal Account v. Hilton Hotels Corp., 780 A.2d 245 (Del. 2001)).

55 Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946 (Del. 1985).

56 *Selectica*, 2010 WL 703062 at *12 (quoting *Unocal*, 493 A.2d at 955).

57 *Id.* (quoting Unocal, 493 A.2d at 955).

58 Unitrin, Inc. v. Am. Gen. Corp., 651 A.2d 1361 (Del. 1995).

59 *Selectica*, 2010 WL 703062 at*12 (citing *Unitrin*, 651 A.2d at 1387).

60 *Id.* at *15.

61 *Id.*

62 *Id.*

63 *Id.*

64 *Id.* at *19-*21.

65 *Id.* at *20 n.169.

66 *Id.* at *20 (quoting Carmody v. Toll Bros., Inc., 723 A.2d 1180, 1195 (Del. 1998)).

67 The free-rider problem is that, although the insurgent investor bears the full costs of the proxy contest, all the shareholders share the benefits of the take-over pro rata according to their interests in the company. Of course, if the company has to reimburse the expenses of shareholders victorious in a proxy contest, this problem is somewhat abated (but not completely, because the insurgent still bears its own costs if it loses the contest). *See id.* at *21 n.183.

68 *Id.* at *20-21.

69 *Id.* at *21.

70 *Id.*

71 *Id.* at *21 n. 189.

72 *Id.* at *21.

73 *Id.* at *22.

74 *Id.* at *23.

75 *Id.*

76 *Id.* at *24.

77 *Id.* at *23.

78 As the Delaware Supreme Court stated in *Moran*, the "key variable in proxy contest success is the merit of an insurgent's issues, not the size of his holdings." Moran v. Household Int'l, Inc., 500 A.2d 1346, 1355 (Del. 1985). Or, in other words, the other shareholders can be counted upon to vote in their perceived financial self-interest. Indeed, the very free-rider problem that deters an insurgent from launching a proxy contest helps the insurgent win those contests that it does launch.

79 Assuming the pill was implemented through a flip-in event, the situation is more complicated than the text implies because, in the typical flip-in, the rights become options to purchase a certain dollar amount of the target's stock for an exercise price equal to half of that amount (e.g., $200 dollars worth of stock for $100). Assuming all or most of the rights are exercised (and there would be no reason for their holders not to exercise them immediately, except perhaps for difficulty in financing the exercise price), the company would experience a tremendous influx of cash, perhaps aggregating many times its pre-transaction market capitalization. What the board would do with this cash, of course, is impossible to say, but if it remained in the company, the raider, in tendering for the shares of the target, would have to increase its offering price dollar-for-dollar to reflect the value of this cash. Assuming the raider acquired the company with the cash still in it, however, there would be no net increase in the acquirer's costs of completing the acquisition. *See generally* Carney & Silverstein, *supra* note 2.

Criminal Law & Procedure

The Inadequate Jurisprudence of Adequate State Grounds

*By Kent Scheidegger & Tom Gede**

The United States Supreme Court has inched its way toward clarifying the standards that define whether a state procedural ruling is "adequate" so as to preclude federal court review. Unfortunately, it has failed to adopt a consistent standard, leaving state court rulings subject to "second-guessing" by federal courts. On December 8, 2009, the Court decided *Beard v. Kindler*,[1] holding narrowly that a state procedural rule is not automatically "inadequate" simply because the rule is discretionary rather than mandatory.[2] But the Court declined to articulate a clearer understanding of "inadequacy" for such state rules, deferring that step for a case that might be a more suitable "vehicle for providing broad guidance on the adequate state ground doctrine."[3] In another case presenting an opportunity to refine the standard, *Philip Morris USA v. Williams*,[4] the Court granted certiorari and had squarely before it the opportunity to clarify the adequate state ground doctrine and adopt a standard of fair notice and reasonable opportunity. On March 31, 2009, however, the Court dismissed the writ of certiorari in *Philip Morris* as improvidently granted.[5] This paper describes the adequate state ground doctrine as it exists today and offers a clearer standard that, if adopted by the Court, would be consistently workable and understandable by state and federal courts.

I. The Present State of the Adequate State Ground Doctrine

Generally, federal courts will not review a question of federal law decided by a state court if that decision rests on a state law ground, whether substantive *or procedural*, that is independent of the federal question and adequate to support the judgment.[6] The question whether a state procedural ruling serves as an "adequate" ground to bar federal review, including federal habeas corpus review, is itself a question of federal law.[7] Most often the doctrine arises in the form of a "procedural default," where the petitioner failed to comply with a rule of state procedure, thereby subjecting himself to a bar to federal review or federal habeas corpus relief. For example, the petitioner in *Wainwright v. Sykes* claimed in federal habeas review that certain statements he made and that were offered against him at trial were obtained in violation of his *Miranda*[8] rights.[9] He was tried and convicted in a Florida court without moving to suppress the statement before trial or contemporaneously objecting to the statements at trial. Florida law bars subsequent relief when a petitioner fails to challenge such a statement.[10] Ultimately, the U.S. Supreme Court, explaining the salutary effect of the contemporaneous objection rule and the need for finality of the state court judgment, upheld the procedural default involved as an adequate state ground and denied the habeas relief.[11] A safeguard in the form of a "cause" and "prejudice" showing, the Court noted, served to prevent a miscarriage of justice.[12] More recently, the Court in *Coleman v. Thompson* noted the underlying federalism concerns in the adequate state ground doctrine:

> In the habeas context, the application of the independent and adequate state ground doctrine is grounded in concerns of comity and federalism. Without the rule, a federal district court would be able to do in habeas what this Court could not do on direct review; habeas would offer state prisoners whose custody was supported by independent and adequate state grounds an end run around the limits of this Court's jurisdiction and a means to undermine the State's interest in enforcing its laws.[13]

Notwithstanding the rather straight-forward notion that failure to comply with state procedural requirements may serve as an adequate ground to bar subsequent federal relief, the mischief arises in the application of the doctrine by federal courts. In *James v. Kentucky*, the Supreme Court framed the adequacy inquiry by asking whether the state rule was "firmly established and regularly followed."[14] Some federal courts, seizing upon this language, have been quick to find state court rules and rulings "inadequate" because the rulings, in the courts' judgment, are inconsistently applied or are poorly defined.[15]

The Ninth Circuit Court of Appeals has granted relief to habeas petitioners in California in decisions, for example, holding that California's "timeliness" rule—where a petitioner must justify any "significant" or "substantial" delay in seeking habeas corpus relief—is standardless, poorly defined, and thus "inadequate" to bar federal habeas relief.[16] The court of appeals in *King v. LaMarque* said this timeliness rule did not adequately define what period of time or factors constitute "substantial delay" and that there were "no standards for determining what factors justify any particular length of delay."[17] In *Martin v. Walker*,[18] the Ninth Circuit, relying on *King* and *Townsend v. Knowles*,[19] twice reversed the findings of a lower court that the state timeliness procedural default rule was adequate. *Martin* involved a petitioner who, in state court, filed a habeas petition five years after the case was final on direct review, and who did not claim that the cause-and-prejudice or actual-innocence exceptions applied. Because California chose to use a general standard of "substantial delay" rather than a rigid cutoff, and because that standard has not been "firmly defined" (i.e., made rigid) through case law, the state rule was deemed "inadequate."

The Ninth Circuit's expectation that state procedural rules must be more "certain" than they already are exemplifies the present confused state of procedural default law and appears to spring from a desire "to peer majestically over the [state] court's shoulder so that [they] might second-guess its" application of its own rules.[20] In the absence of a procedural trap, an evasion of federal law, or at least probable cause to suspect either of

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these, there is no policy justification for such intense federal court scrutiny of state procedures.

The Ninth Circuit's suspicion of state procedural holdings contrasts sharply with the holding of the Supreme Court in a closely related context in *Carey v. Saffold*,[21] where, for the purpose of implementing the federal statute of limitation's tolling provision, the Court directed that the state court's decision regarding whether a petition was timely filed should be accepted as conclusive without further inquiry. "If the California Supreme Court had clearly ruled that Saffold's 4½-month delay was 'unreasonable,' *that would be the end of the matter*, regardless of whether it also addressed the merits of the claim, or whether its timeliness ruling was 'entangled' with the merits."[22]

To be sure, the blame for this conflicting precedent does not rest entirely with the courts of appeals that have been restrictive regarding what constitutes an inadequate state ground. The Supreme Court's precedents regarding what state grounds are "inadequate" form a haphazard patchwork.[23]

Early articulations include where the rules were applied "without any fair or substantial support,"[24] as an "arid ritual of meaningless form,"[25] where the defendant "could not fairly be deemed to have been apprised of [the rule's] existence,"[26] where a rule had not been previously applied "with the pointless severity of the present case,"[27] or where it "impos[ed] unnecessary burdens upon [federal] rights."[28] Other articulations referred to where the rules were "more properly deemed discretionary than jurisdictional,"[29] or were "not strictly or regularly followed,"[30] and finally whether "the practice gives to the litigant a reasonable opportunity to have the issue as to the claimed right heard and determined by [the state] court."[31]

Many of the older cases arose out of the civil rights struggles of the 1950s and 1960s. The distrust of discretionary or less-than-strict rules is likely based in the suspicion they were being used discriminatorily against federal rights, civil rights organizations, and black criminal defendants,[32] and at the time that suspicion was often justified. *Saffold* implies that this time is long past.[33] Over forty years later, the possibility of evasion or discrimination may not have vanished entirely but is a faint shadow of what it was in 1964. Today, the cure is far worse than the disease. A state court's decision to enforce a procedural default rule, find it inapplicable, or find good cause to waive it should be presumed to be in good faith in the absence of solid evidence to the contrary. The mere fact that the state rules have not been specified with such mechanical rigidity as to predetermine the outcome in every case is not sufficient to declare the rule inadequate. Flexibility and discretion in the application of default rules should be encouraged, not discouraged.

In any case, if the state courts really did exercise discretion so as to discriminate on the basis of race or against fundamental rights, it would be a violation of the Equal Protection Clause by itself. A requirement of truly strict application could only be justified as a kind of conclusive presumption to relieve the claimant of the difficult burden of proving discrimination. Such presumptions should only be used where they produce the correct result most of the time.[34] Presuming discrimination from a lack of iron rigidity in the application of default rules would reach the wrong result nearly all of the time.

Given the Supreme Court's evolving jurisprudence of "adequate state grounds" and inconsistent language, it is hardly surprising that the field has produced a large number of decisions that appear hostile to state rules of procedure.[35] *Kindler*, noted above, took a step in the right direction, effectively disapproving language in *Sullivan v. Little Hunting Park, Inc*.[36] that Justice Harlan in dissent had called "unclear and confusing,"[37] and a "loose use of the word 'discretionary.'"[38] In *Kindler*, the petitioner was a twice-escaped fugitive returned to custody. The Pennsylvania courts held that his escapes forfeited certain claims challenging his conviction and sentence that he once had been entitled to bring. This is referred to as the "fugitive forfeiture" rule. The Third Circuit Court of Appeals noted, however, that the Pennsylvania courts had *discretion* to hear an appeal filed by a fugitive who had been returned to custody before an appeal was initiated or dismissed. "Accordingly," the court ruled, "the fugitive forfeiture rule was not 'firmly established' and therefore was not an independent and adequate procedural rule sufficient to bar review of the merits of a habeas petition in federal court."[39] The state trial court still had discretion to reinstate Kindler's post-verdict motions, so the Third Circuit concluded that Pennsylvania's fugitive waiver law did not preclude the federal court from reviewing the merits of the claims raised in his federal habeas petition.[40]

Providing some limited clarification of the adequacy landscape, the Supreme Court reversed the Third Circuit and held that a discretionary state procedural rule can serve as an adequate ground to bar federal habeas review.[41] The Court continued:

> Nothing inherent in such a rule renders it inadequate for purposes of the adequate state ground doctrine. To the contrary, a discretionary rule can be "firmly established" and "regularly followed"—even if the appropriate exercise of discretion may permit consideration of a federal claim in some cases but not others. See Meltzer, State Court Forfeitures of Federal Rights, 99 Harv. L. Rev. 1128, 1140(1986) ("[R]efusals to exercise discretion do not form an important independent category under the inadequate state ground doctrine").[42]

The *Kindler* Court said its ruling was uncontroversial and noted, citing the State of California's brief, that the states seem to value discretionary rules as much as the federal government does. It then concluded that "in light of the federalism and comity concerns that motivate the adequate state ground doctrine in the habeas context, it would seem particularly strange to disregard state procedural rules that are substantially similar to those to which we give full force in our own courts."[43]

The true significance of *Kindler* lies in its recitation of the notion that a discretionary rule can be "firmly established" and "regularly followed"—refuting the gravamen of Kindler's claim, namely that petitioners can suffer from infrequent or discriminate application of discretion. The Court answered Kindler's complaint by noting that a rigid and uniform rule "would be more likely to impair [the trial judge's] ability to deal fairly with a particular problem than to lead to a just result."[44] The result, the Court stated, would be "particularly unfortunate for criminal defendants, who would lose the opportunity to

argue that a procedural default should be excused through the exercise of judicial discretion."[45] The Court's opinion suggests that there is no federal interest in compelling or even encouraging the states to purge all discretion from the operation of their procedural default rules. Nor is there is any federal interest in denying effect to any state procedural rule which is not "strictly" applied in the sense of iron-clad severity because such a formulation provides a perverse incentive for states to make their default rules more severe and less flexible than the state might otherwise choose.

But the *Kindler* Court did not follow the Commonwealth's suggestion to undertake an effort to state a new, clear standard for inadequacy. The procedural default at issue in *Kindler*—escape from prison—was according to the Court, "hardly a typical procedural default, making this case an unsuitable vehicle for providing broad guidance on the adequate state ground doctrine." However, a single, coherent standard is long overdue. The standard should accommodate the need to respect state procedures while recognizing the responsibility of the states to provide meaningful remedies for federal claims, and opening the door to federal relief when they do not.

II. A Standard Based on Fair Notice and Reasonable Opportunity

We suggest that a workable and coherent standard for an adequate state ground doctrine is available and can be gleaned from existing relevant jurisprudence. That standard can be formed by combining the "fairly . . . apprised" language from *NAACP v. Alabama ex rel. Patterson*,[46] with *Central Union*'s "reasonable opportunity."[47] That is, the claimant should have fair notice that the rule exists and applies to the circumstances, and he should have a reasonable opportunity to present his federal claim.[48] Nothing more is required.

Courts have long discussed the notions of fair notice. As long as an inherently fair rule is clear in advance of the process or procedures facing the petitioner, no one can complain. Of course, a rule unfairly applied retroactively is intolerable. For example, a state may legitimately specify in advance which of two possible remedies a claimant must pursue, but it cannot "bait and switch."[49] Similarly, there is a federal interest in protecting federal rights from *unforeseeable* applications of existing rules. A competent lawyer should be able to discern the contours of the rule with sufficient clarity that he or she knows what to do to safely preserve the claim.[50] Fair notice means that a procedure that appears to be in clear compliance cannot suddenly be declared to be a default.

Nearly all of the cases where the Supreme Court has declared a state procedural rule to be inadequate fit within the standard we propose. For example, in *James v. Kentucky*, the state court declared the defendant's claim to be defaulted because he had asked for a jury "admonition" rather than an "instruction," but the state's case law at the time of the trial was too confused to give fair notice of that distinction.[51] A "reasonable notice" standard corrects the unfairness of this situation without the problematic practice of probing whether a state rule is "regularly followed."

The "reasonable notice" prong of our proposal is derived from *Central Union Tel. Co. v. Edwardsville*.[52] The standard suggests a sensible and clear element for a procedural bar—whether "the practice gives to the litigant a reasonable opportunity to have the issue as to the claimed right heard and determined by [the state] court."[53] An example of a rule that generally provides fair notice but was applied in a way as to deprive the appellant of a reasonable opportunity can be found in *Hathorn v. Lovorn*.[54] That case involved a rule against making arguments for the first time on petition for rehearing, a widely followed and generally unobjectionable rule. In the particular case, though, the state court had salvaged a facially unconstitutional statute through drastic and unexpected surgery, thereby raising a different federal question from the one originally presented.[55] As a practical matter, the petition for rehearing was the first opportunity to raise this claim. Federal rights need protection from an unreasonable refusal to make a needed exception to a normally fair rule.

A single, simple, clear standard in this area is long overdue. That standard must respect the state court process, comity, and federalism and yet protect federal interests. Fair notice of procedural rules and a reasonable opportunity to make the claim fits the bill.

Endnotes

1 130 S. Ct. 612 (2009).

2 *Id*. at 618.

3 *Id*. at 619.

4 No. 07-1216, *cert. dismissed as improvidently granted*, 129 S. Ct. 1436 (2009).

5 *Id*.

6 *See* Coleman v. Thompson, 501 U.S. 722, 729 (1991) (citing Fox Film Corp. v. Muller, 296 U.S. 207 (1935).

7 Lee v. Kemna, 534 U. S. 362, 375 (2002).

8 Miranda v. Arizona, 384 U.S. 436 (1966).

9 Wainwright v. Sykes, 433 U.S. 72, 74 (1977).

10 *Id*. at 76-77.

11 *Id*. at 90-91.

12 *Id*. at 91.

13 Coleman v. Thompson, 501 U.S. 722, 730 (1991).

14 James v. Kentucky, 466 U.S. 341, 348 (1984).

15 *See, e.g.,* Townsend v. Knowles, 562 F.3d 1200 (9th Cir. 2009); King v. LaMarque, 464 F.3d 963 (9th Cir. 2009).

16 King v. LaMarque, 464 F.3d.

17 *Id*.

18 No. 08-15752 (9th Cir., Nov. 20, 2009), *cert. pending sub. nom.* Walker v. Martin, No. 09-996.

19 Townsend v. Knowles 562 F.3d.

20 *Cf.* Lewis v. Jeffers, 497 U.S. 764, 780-781 (1990) (quoting Godfrey v. Georgia, 446 U.S. 420, 450 (1980) (White, J., dissenting)).

21 536 U.S. 214 (2002).

22 *Id*. at 226 (emphasis added).

23 *See* Richard H. Fallon, Jr., Daniel J. Meltzer & David L. Shapiro, Hart & Wechsler's The Federal Courts and the Federal System 557 (5th ed. 2003).

24 Ward v. Board of Comm'rs, 253 U.S. 17, 22 (1920).

25 Staub v. City of Baxley, 355 U.S. 313, 320 (1958).

26 NAACP v. Alabama *ex rel.* Patterson, 357 U.S. 449, 457 (1958).

27 NAACP v. Alabama *ex rel.* Flowers, 377 U.S. 288, 297 (1964).

28 Brown v. Western R. Co. of Ala., 338 U.S. 294, 298 (1949).

29 Sullivan v. Little Hunting Park, Inc., 396 U.S. 229, 234 (1969).

30 Barr v. City of Columbia, 378 U.S. 146, 149 (1964).

31 Cent. Union Tel. Co. v. Edwardsville, 269 U.S. 190, 194-195 (1925); Parker v. Illinois, 333 U.S. 571, 574 (1948) (quoting and following *Central Union*).

32 *See* Glennon, 61 Tenn. L. Rev., at 895 (noting "state court efforts to use their procedural rules to impede the civil rights movement").

33 *See also* Stone v. Powell, 428 U.S. 465, 493-494 n.35 (1976).

34 *See* Coleman v. Thompson, 501 U.S. 722, 730 (1991).

35 For commentary, see, e.g., Fallon, Meltzer & Shapiro, *supra* note 23; Hill, *The Inadequate State Ground*, 65 Colum. L. Rev. 943, 944 (1965).

36 Sullivan v. Little Hunting Park, Inc., 396 U.S. 229 (1969).

37 *Id.* at 243.

38 *Id.* at 245.

39 Kindler v. Horn, 542 F.3d 70, 79 (3d Cir. 2008) (citing Doctor v. Walters, 96 F.3d 675, 684-686 (3d Cir. 1996)).

40 *Kindler*, 542 F.3d at 80.

41 Beard v. Kindler, 130 S. Ct. 612, 618 (2009).

42 *Id*.

43 *Id*. (referring to Francis v. Henderson, 425 U.S. 536, 541-542 (1976)).

44 *Id*. (citing United States v. McCoy, 517 F.2d 41, 44 (7th Cir.) (Stevens, J.), *cert. denied*, 423 U.S. 895 (1975)).

45 *Id*. (citing Henry v. Mississippi, 379 U.S. 443, 463 n.3 (1965) (Harlan, J., dissenting)).

46 *See supra* note 26.

47 *See supra* note 31.

48 *See* 16B C. Wright, A. Miller & E. Cooper, Federal Practice and Procedure 386-387, 392 (2d ed. 1996).

49 *See* Reich v. Collins, 513 U.S. 106, 111 (1994).

50 *See* Walker v. Birmingham, 388 U.S., 307, 320 (1977) (finding that petitioners were "on notice" of the correct procedure and not "entrapped or misled").

51 466 U.S. 341, 346-348 (1984).

52 Cent. Union Tel. Co. v. Edwardsville, 269 U.S. 190, 194-195 (1925).

53 *Id*.

54 457 U. S. 255 (1982).

55 *Id.* at 258-259.

Swinging a Sledge: The Right to Effective Assistance of Counsel, the Law of Deportations, and *Padilla v. Kentucky*

*By Joseph M. Ditkoff**

In *Padilla v. Kentucky*,[1] the Supreme Court decided that the Sixth Amendment's guarantee of the effective assistance of legal counsel requires that counsel inform his client whether his guilty plea in a criminal case carries a risk of deportation. The Court's decision significantly expands the reach of the traditional Sixth Amendment constitutional protection afforded criminal defendants via the long-established rule of *Strickland v. Washington*,[2] and, concomitantly, significantly alters the landscape of what courts will consider to be adequate representation in criminal proceedings. The precise contours of the right, thus expanded, will be left to the vagaries of the common law in both state and federal court to map out. This short article will discuss *Padilla* and some of its forebears and foreshadowings. As will be seen, the Supreme Court has again left prosecutors, defense counsel, and judges with a somewhat muddy decision that leaves the hard work for later, and for others.

Padilla involved a defendant who was a native of Honduras, and who had for forty years been a lawful, permanent resident of the United States before he pleaded guilty in the Commonwealth of Kentucky to transporting marijuana in his tractor-trailer.[3] Resolving the case short of trial and with the assistance of his attorney, Padilla pleaded guilty to some charges, the government agreed to forego the remaining charge, and the court sentenced Padilla to five years incarceration and five years of probation.[4] Facing deportation, Padilla several years later filed a motion for post-conviction relief, alleging that his attorney failed to advise him of the possibility of his deportation, and in fact even went so far as to tell Padilla that he "did not have to worry about immigration status since he had been in the country so long."[5] The Supreme Court of Kentucky refused to grant Padilla relief. Even assuming that Padilla's allegations were true, the court held that incorrect advice on consequences *collateral* to a criminal prosecution, or the failure to give advice at all, simply did not fall within the ambit of the Sixth Amendment's guarantee of the effective assistance of counsel. Specifically, the Kentucky court held, citing its own controlling precedent, that "collateral consequences are outside the scope of representation required by the Sixth Amendment and that failure of defense counsel to advise the defendant of possible deportation consequences is not cognizable as a claim for ineffective assistance of counsel."[6]

The United States Supreme Court, after granting certiorari, disagreed. The majority began with a short history of recent developments in immigration law:

> While once there was only a narrow class of deportable offenses and judges wielded broad discretionary authority to prevent deportation, immigration reforms over time have expanded the class of deportable offenses and limited the authority of judges to alleviate the harsh consequences of deportation. The drastic measure of deportation or removal . . . is now virtually inevitable for a vast number of noncitizens convicted of crimes.[7]

The Court discussed the Immigration and Naturalization Act of 1917 and its abundance of provisions for the deportation of noncitizens for various forms of disapproved conduct committed on our shores.

Importantly for the Court, however, the laws of the time provided for a judicial safety valve of sorts, a type of fail-safe mechanism that the majority, not surprisingly, found laudable. The 1917 Act

> included a critically important procedural protection to minimize the risk of unjust deportation: At the time of sentencing or within 30 days thereafter, the sentencing judge in both state and federal prosecutions had the power to make a recommendation "that such alien shall not be deported." This procedure, known as a judicial recommendation against deportation, or JRAD, had the effect of binding the Executive to prevent deportation; the statute was "consistently . . . interpreted as giving the sentencing judge conclusive authority to decide whether a particular conviction should be disregarded as a basis for deportation."[8]

With this safety net secure, the Supreme Court saw no need to pass on whether, or how, advice concerning immigration consequences fell under *Washington*'s[9] purview.

In time, however, attitudes changed and power shifted, as the majority took care to note. Congress greatly limited the ambit of the JRAD procedure in 1952, and then, in 1996, eliminated it root and branch.[10] The Court laid this out plainly in its opinion:

> Under contemporary law, if a noncitizen has committed a removable offense after the 1996 effective date of these amendments, his removal is practically inevitable but for the possible exercise of limited remnants of equitable discretion vested in the Attorney General to cancel removal for noncitizens convicted of particular classes of offenses.[11]

Uncomfortable with what it labeled the "practically inevitable," the Court proceeded to carve out of the immigration law landscape a criminal law escape hatch. The escape hatch is accessed through the Sixth Amendment's guarantee of effective counsel.

Observing that the Supreme Court of Kentucky rebuffed Padilla's attempt to withdraw his plea where his claim rested solely on his attorney's profoundly erroneous advice regarding

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the immigration consequences that would result, the Court explained that a defendant's deportation from the country, triggered by a criminal conviction, is not necessarily a consequence completely collateral to the criminal prosecution. Although not strictly punishment, that is, a criminal sanction, deportation is, in the Court's view, a penalty nonetheless, and a consequence inextricably intertwined with the criminal proceeding. The Court noted that there was and had been a great degree of judicial difference of opinion,[12] but, in the end, it made plain that it was coming down on the side of the criminally-accused noncitizen. The Court stated:

> Deportation as a consequence of a criminal conviction is, because of its close connection to the criminal process, uniquely difficult to classify as either a direct or a collateral consequence. The collateral versus direct distinction is thus ill-suited to evaluating a *Strickland* claim concerning the specific risk of deportation. We conclude that advice regarding deportation is not categorically removed from the ambit of the Sixth Amendment right to counsel.[13]

With the analytic structure thus deployed, and the issue so framed, the Court did not find it difficult to conclude that Padilla's lawyer's advice that Padilla "did not have to worry about immigration status since he had been in the country so long" fell below the *Washington* standard of basic "reasonableness" of counsel's representation in a criminal prosecution. The Court looked to a wide range of professional performance guidelines and standards of effective representation to evaluate and measure the performance of Padilla's counsel.[14] From this canvassing, the Court determined that the vast majority of the relevant authorities "'require defense attorneys to advise as to the risk of deportation consequences for non-citizen clients . . . .'"[15]

Turning back to Padilla's predicament, the Court quoted the relevant statute,[16] and proceeded to evaluate counsel's performance in light of the circumstances. The Court's judgment was not particularly favorable:

> Padilla's counsel could have easily determined that his plea would make him eligible for deportation simply from reading the text of the statute, which addresses not some broad classification of crimes but specifically commands removal for all controlled substances convictions except for the most trivial . . . . Instead, Padilla's counsel provided him false assurance that his conviction would not result in his removal from this country. This is not a hard case in which to find deficiency: The consequences of Padilla's plea could easily be determined from reading the removal statute, his deportation was presumptively mandatory, and his counsel's advice was incorrect.[17]

On its own terms, though, the majority underestimated the complexity of immigration law. Even where there can be no question that a conviction will subject one to deportation, this is of little moment unless the defendant is not *already deportable* for some other reason. Putting aside the possibility of another conviction (often under a different name),[18] a defendant might be deportable if he is on welfare within five years of entering the United States,[19] if he votes,[20] if he fails to update his address within ten days of moving,[21] or simply if he was inadmissible when he entered the United States.[22] Indeed, if Padilla himself was a drug addict at any time after his entry into the United States, he is deportable regardless of his conviction.[23] If a criminal defense attorney advised a defendant that he would be deported if he pled guilty to a crime, causing his client to eschew a favorable sentence, the defendant would no doubt challenge a conviction after trial on the ground that his attorney should have advised him that he was deportable in any event. All of these statutes are "succinct, clear, and explicit in defining the removal consequences,"[24] but the application of them to any particular defendant is anything but, even if a state criminal defense attorney should be expected to be familiar with such obscure (to a non-immigration specialist) provisions of the federal code.

Furthermore, the majority simply assumed that legally-mandated immigration consequences actually happen. In fact, it was not until 2008 and the tenure of Julie L. Myers as head of Immigration and Customs Enforcement (ICE) that ICE first formulated a plan to integrate state prisons and county jails into federal databases that would identify deportable aliens. In practice, ICE lacks the resources to remove every deportable alien. There are literally millions of deportable aliens in the United States who, though deportable by the terms of "succinct, clear, and explicit" statutes, are in no danger of deportation. What "a reasonably competent attorney" would do when faced with a client who technically could be deported but likely would not be deported is left to the imagination.[25]

Even where the attorney is well-versed in immigration law, things are not simple. In 1999, my office filed a brief in the Massachusetts Supreme Judicial Court in an operating-under-the-influence case.[26] At that time, the state of federal law was that such a conviction was deportable, and my office so conceded.[27] Five years later, the United States Supreme unanimously decided that the answer was the opposite.[28]

Of course, these concerns did not escape the Court's attention entirely. In a comprehensive concurrence, Justice Alito took the majority to task for its expansion of Sixth Amendment requirements, and its effective redefinition of the meaning of the effective assistance of counsel. While concurring in the bottom-line judgment of the Court—that is, agreeing that if an attorney affirmatively misleads a client who is not a citizen of the deportation consequences of a criminal conviction, he has provided ineffective assistance as a matter of law—Justice Alito was adamant in his fundamental disagreement with the majority's central, broader holding.[29] In Justice Alito's view, a competent attorney must not provide wholly-incorrect advice, but should instead tell his client that, if the client has concerns about the conviction's effect on his immigration status, he should talk to a specialist in the immigration law field.[30] The Sixth Amendment, however, does not command that an attorney, retained in a criminal case, must try his or her best to explain to the client what those consequences could possibly be.[31] This is the domain of the immigration specialist, not the run-of-the-mine criminal defense attorney. The freshly minted *Padilla* rule, said Justice Alito, amounts to a "vague, halfway test [that] will lead to much confusion and needless litigation."[32]

And, indeed, it is hard to argue with Justice Alito's main point. Immigration law *is* complex, exceedingly so, as Justice

Alito demonstrated.[33] The majority admitted this, to its credit.[34] Criminal defense attorneys may be less than expert in the field, if not entirely ignorant. Again, the majority conceded this. But the majority proceeded to hold the following:

> When the law is not succinct and straightforward . . . a criminal defense attorney need do no more than advise a noncitizen client that pending criminal charges may carry a risk of adverse immigration consequences. But when the deportation consequence is truly clear, as it was in this case, the duty to give correct advice is equally clear.[35]

The unclear case, then, will have to wait.

But, after the clarity recedes, the forecasted storms are not hard to envision, and Justice Alito did so:

> How can an attorney who lacks general immigration law expertise be sure that a seemingly clear statutory provision actually means what it seems to say when read in isolation? What if the application of the provision to a particular case is not clear but a cursory examination of case law or administrative decisions would provide a definitive answer?[36]

Or, perhaps, what is required is not quite a cursory examination, but one a little more comprehensive, though not by too much? It is difficult to see an end to these potential problems.

Indeed, the expansiveness of the new doctrine should weigh heavy on current counsel and extant convictions. Criminal defense attorneys will have to apprise themselves of statutory and case law, new and old, all in the unrelated field of immigration law, in order to provide constitutionally-effective assistance *in the context of a criminal prosecution*. As noted, the majority engaged in an extended discussion as to just why what has in the past, and by other reviewing courts, been considered an indirect consequence of a criminal conviction has now become the stuff of the Sixth Amendment. The majority's reasoning, as quoted above, is simple enough by the Court's own lights, and the average defense attorney's responsibilities have become a lot more complicated.

In the end, and as it has done in the past, in order to fashion a just result in a nondescript case with a sympathetic petitioner, the Court created a constitutional requirement whose precise contours must await another day to be limned. The Court observed that states themselves have taken the lead over the years to ensure that defendants within their respective jurisdictions would not find themselves in Padilla's unfortunate situation by requiring trial judges to inform criminal defendants of the possibility that their convictions might well have uncertain, and unwanted, immigration consequences.[37] Nonetheless, the majority could not resist the opportunity to do its best to ensure that no noncitizen should find himself in Padilla's position again.

In his stinging dissent, Justice Scalia reiterated what for him had been a jurisprudential crusade of longstanding:

> In the best of all possible worlds, criminal defendants contemplating a guilty plea ought to be advised of all serious collateral consequences of conviction, and surely ought not to be misadvised. The Constitution, however, is not an all-purpose tool for judicial construction of a perfect world; and when we ignore its text in order to make it that, we often find ourselves swinging a sledge where a tack hammer is needed.[38]

A criminal defense attorney's constitutional obligations to his client should extend only to matters occurring in the circumscribed context of the criminal case alone; otherwise, as Justice Scalia noted, there is no terminus to those obligations whose outlines can fairly be discerned by even the most scrupulous lawyer.[39] Indeed, Justice Scalia quoted Justice Alito's concurrence:

> "[A] criminal convictio[n] can carry a wide variety of consequences other than conviction and sentencing, including civil commitment, civil forfeiture, the loss of the right to vote, disqualification from public benefits, ineligibility to possess firearms, dishonorable discharge from the Armed forces, and loss of business or professional licenses. . . . All of those consequences are 'serious,' . . . ."[40]

And so, in the end, will be the consequences of the majority's rule in *Padilla*. The Sixth Amendment, thus construed, now imposes expansive obligations on attorneys whose customary expertise is criminal law, not immigration law, and now exposes countless guilty pleas to post-conviction attack based on alleged infirmities and missteps in those newly-minted obligations. "My lawyer told me not to worry." Or he told me nothing at all. The Sixth Amendment ought not be stretched so far because, at some point, it is sure to snap.

Endnotes

1 Padilla v. Kentucky, 130 S. Ct. 1473 (2010).

2 Strickland v. Washington, 466 U.S. 668 (1984).

3 *Padilla*, 130 S. Ct. at 1477.

4 Commonwealth v. Padilla, 253 S.W.2d 482, 483 (Ky. 2008).

5 *Id.*

6 *Id.* at 484.

7 *Padilla*, 130 S. Ct. at 1478 (internal quotation marks omitted).

8 *Id*. at 1479 (citation omitted) (ellipsis in the original) (quoting Janvier v. United States, 793 F.2d 449, 452 (2d Cir. 1986)).

9 The Supreme Court repeatedly short cited *Strickland v. Washington* as *Strickland*, *see, e.g.*, *Padilla*, 130 S. Ct. at 1481, 1482, 1484, as if Strickland were the criminal defendant and Washington referred to the State of Washington. *Id.* In fact, David Leroy Washington was the criminal defendant, and Charles E. Strickland was the Superintendent of the Florida State Prison.

10 104 Stat. 1550 (1996).

11 *Padilla*, 130 S. Ct. at 1480.

12 *Id*. at 1481 & n.8.

13 *Id*. at 1482.

14 *Id*. at 1482-83.

15 *Id*. at 1482 (quoting Brief for Legal Ethics, Criminal Procedure, and Criminal Professors as Amicus Curiae at 12-14).

16 8 U.S.C. § 1227(a)(2)(B)(i) ("[A]ny alien who at any time after admission has been convicted of a violation of (or a conspiracy or attempt to violate) any law or regulation of a State, the United States or a foreign country related to a controlled substance . . ., other than a single offense involving possession for

one's own use of 30 grams or less of marijuana, is deportable.").

17 *Padilla*, 130 S. Ct. at 1483.

18 In fact, Padilla himself may be independently deportable for receiving stolen property in California. *See* Brief of the United States at 2, Padilla v. Kentucky, 130 S. Ct. 1473 (2010).

19 8 U.S.C. § 1227(a)(5).

20 *Id.* § 1227(a)(6)(A).

21 *Id.* § 1227(a)(1)(A).

22 *Id.* § 1227(a)(1)(A).

23 *Id.* § 1227(a)(2)(B)(ii).

24 Padilla v. Kentucky, 130 S. Ct. 1473, 1483 (2010).

25 Strickland v. Washington, 466 U.S. 668, 687 (1984) (internal quotation marks omitted).

26 Commonwealth v. Rzepphiewski, 725 N.E.2d 210 (Mass. 2000).

27 *See* Duan v. Attorney General, 196 F.3d 1352 (11th Cir. 1999); Matter of Puente-Salazar, 22 I. & N. Dec. 1006, 1012-13 (BIA 1999) (en banc). Why that mattered in a state criminal case is a complicated question of Massachusetts law, and it would serve little purpose to explain it here.

28 Leocal v. Ashcroft, 543 U.S. 1 (2004).

29 *Padilla*, 130 S. Ct. at 1487 (Alito, J., concurring).

30 *Id*. at 1487, 1494.

31 *Id.* at 1491-92.

32 *Id*. at 1487.

33 *Id.* at 1489-90.

34 *Id*. at 1483 (majority opinion).

35 *Id*.

36 *Id*. at 1490 (Alito, J., concurring).

37 The Court cited the following statutes: Alaska R. Crim. P. 11(c)(3)(C) (2009-10); Cal. Penal Code Ann. § 1016.5 (West 2008); Conn. Gen. Stat. § 54-lj (2009); D.C. Code § 16-713 (2001); Fla. R. Crim. Proc. 3.172(c)(8) (Supp. 2010); Ga. Code Ann. § 17-7-93(c) (1997); Haw. Rev. Stat. Ann. § 802E-2 (2007); Iowa R. Crim. P. 2.8(2)(b)(3) (Supp. 2009); Md. R. 4-242 (Lexis 2009); Mass. Gen. Laws ch. 278, § 29D (2009); Minn. R. Crim. P. 15.01 (2009); Mont. Code Ann. § 46-12-210 (2009); N.M. R. Crim. Form 9-406 (2009); N.Y. Crim. Proc. Law Ann. § 220.50(7) (West Supp.2009); N.C. Gen. Stat. Ann. § 15A-1022 (Lexis 2007); Ohio Rev. Code Ann. § 2943.031 (West 2006); Ore. Rev. Stat. § 135.385 (2007); R.I. Gen. Laws § 12-12-22 (Lexis Supp.2008); Tex. Code Ann. Crim. Proc. Art. 26.13(a)(4) (Vernon Supp.2009); Vt. Stat. Ann. Tit. 13, § 6565(c)(1) (Supp.2009); Wash. Rev. Code § 10.40.200 (2008); Wis. Stat. § 971.08 (2005-06).

38 *Padilla*, 130 S. Ct. at 1494 (Scalia, J., dissenting).

39 *Id*. at 1495.

40 *Id*. at 1496 (quoting *id.* at 1488 (Alito, J., concurring)).

Environmental Law & Property Rights

Modern Remedies for Antiquated Laws: Challenging National Monument Designations Under the 1906 Antiquities Act

*By Mark C. Rutzick**

In late 2009 rumors emerged that the Obama Administration is contemplating a fresh round of national monument designations under the Antiquities Act of 1906.[1] The Interior Department has confirmed that it has compiled a list of some fourteen "Treasured Landscapes," totaling 13.1 million acres of federal land, that are under consideration for potential designation, but otherwise has declined congressional inquiries into the details of the rumors.[2]

The venerable and controversial Antiquities Act, enacted in the presidency of Theodore Roosevelt, allows the President to proclaim areas of federal lands he determines contain "historic landmarks, historic and prehistoric structures, and other objects of historic or scientific interest" as a national monument, and to "reserve" parcels of land within the monument.[3] Presidents have used the Antiquities Act to create national monuments more than 120 times over the past century. In a single day President Jimmy Carter established fifteen new national monuments in Alaska and expanded two more, containing fifty-six million acres of federal land.[4] In response Congress enacted the Alaska National Interest Lands Conservation Act,[5] overturning most of the designations, altering the status of some and confirming a few, and included a congressional veto on future land withdrawals in the state.[6]

President Clinton proclaimed nineteen new national monuments and expanded three more, reserving 5.9 million acres of land.[7] All but one of these proclamations came in the last year of his presidency, and eleven occurred in the twilight period between the 2000 election and the end of the term.[8] The Clinton designations led to a series of lawsuits unsuccessfully challenging the decisions.[9]

It is easy to understand why President Obama might contemplate a national monument designation for an area of federal land:

a. There is intense daily pressure from dozens of environmental advocacy organizations throughout the country, many of whose members worked hard for President Obama's election, urging the federal government to accord special protection to literally hundreds of particular outdoor areas characterized as biologically or ecologically significant. The principal goal of the requested designations is usually to ban economically productive resource uses such as grazing, mining, oil and gas production, timber removal, and geothermal energy production in the affected area; sometimes limits on active recreation and off-road vehicle use are also demanded. Their focus is almost invariably on lands managed by the Bureau of Land Management (BLM) and the U.S. Forest Service, which between them manage more than 450 million acres of federal land—the majority of the 653 million acres of federal land located throughout the country (concentrated in 12 western states), and, most importantly, virtually all of the federal lands where resource use and development occur.[10]

b. Under the complex web of federal land management laws and associated environmental statutes, altering the management status of an area of federal land generally takes no less than five years and sometimes much longer. The procedural and substantive requirements of these laws command federal management agencies to conduct lengthy periods of environmental review, public comment, consideration and response to public comment, and careful consideration of the complex set of management objectives Congress has by statute prescribed for the BLM in the Federal Land Policy and Management Act (FLPMA),[11] for the Forest Service in the National Forest Management Act (NMFA),[12] and for federal agencies generally in the National Environmental Policy Act (NEPA),[13] the Endangered Species Act (ESA),[14] the Wilderness Act,[15] the Wild and Scenic Rivers Act,[16] and the Clean Water Act (CWA),[17] among others.

c. The principal attraction of the Antiquities Act as it has been used since the emergence of federal environmental legislation is that not a single one of the federal environmental statutes has applied to the President's exercise of his proclamation authority for national monuments. With the literal stroke of a pen on a Presidential proclamation, Presidents Carter and Clinton created a series of enormous national monuments throughout the West and Alaska, some exceeding one million acres in size,[18] and simultaneously reserved that land from any consumptive or extractive resource use.[19]

No one can claim that bypassing every known environmental law is a sound method for making a national monument designation; if it were there would be no need for environmental laws. The anti-environmental effects of the Antiquities Act arise, for better or worse, from the language of the 1906 statute itself.

d. Even more alluring to a President, the Antiquities Act provides no mechanism for a current or future President to repeal a monument designation.[20] President Clinton knew when he proclaimed over one million acres of national monuments on January 17, 2001 that his action could never be undone by a future President—a heady power indeed, especially for a departing executive.

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This article will examine the arguments presented (unsuccessfully) in recent challenges to Clinton proclamations, and will consider whether other, yet-untested legal theories may exist that could lead to a successful challenge in the future.

Language and History of the Antiquities Act

As always, it is useful to begin with the text of the statutory provision in question. The relevant section of the Antiquities Act states:

> The President of the United States is hereby authorized, in his discretion, to declare by public proclamation historic landmarks, historic and prehistoric structures, and other objects of historic or scientific interest that are situated upon the lands owned or controlled by the Government of the United States to be national monuments, and may reserve as a part thereof parcels of land, the limits of which in all cases shall be confined to the smallest area compatible with proper care and management of the objects to be protected.[21]

Proclamations under this statute were relatively common in the first half of the 20th century, up to President Roosevelt's controversial Jackson Hole proclamation in 1943 and Congress' legislative response.[22] The courts faced only two cases in that era involving national monument proclamations. In *Cameron v. United States*,[23] the court held that the 1908 proclamation of the Grand Canyon national monument (before it became a national park) was valid under the Antiquities Act, although the "objects" intended to be protected were natural rather than man-made.[24] In *Wyoming v. Franke*,[25] a district court upheld the controversial Jackson Hole proclamation by deferring to the President's discretion under the Antiquities Act.[26]

After Jackson Hole, Presidents used the Antiquities Act just twice[27] until President Carter's sweeping set of Alaska proclamations in 1978.[28] The State of Alaska challenged the adequacy of the NEPA compliance on the proclamations (the first since enactment of NEPA in 1969), and the court rejected the challenge on the ground NEPA only applies to "federal agencies" and therefore does not require compliance by the President.[29] The Antiquities Act then lay dormant until President Clinton's 1996 proclamation of the Grand Staircase-Escalate National Monument, which reserved 1,870,800 acres of federal land in Utah,[30] followed by his burst of late-term designations noted above.

Thus, when the first Clinton proclamation occurred, there was very little direct legal authority on the interpretation, application and judicial review under the Antiquities Act other than the determination that the statute was lawful.

Recent Judicial Challenges to National Monument Designations

The three cases challenging the Clinton proclamations presented a much wider range of claims than earlier cases, and drew more detailed opinions from the courts, but ultimately all failed, keeping intact the historical verity that no legal challenge to a national monument proclamation has ever succeeded. This record might tempt proclamation opponents to forgo judicial outlet of their grievances. Yet review of the courts' handling of the cases, along with re-examination of earlier litigation and the statute itself, suggests that some potential means of overturning an Antiquities Act proclamation may be available.

1. In *Mountain States Legal Foundation v. Bush*,[31] the plaintiff alleged that six Clinton proclamations violated the Property Clause of the Constitution[32] and the Antiquities Act itself. The district court had dismissed the case, ruling that the constitutional claim was not valid and that review of the proclamations under the Antiquities Act was limited to a "facial" determination whether the proclamations properly invoked the criteria in the law.[33]

The appellate court took a broader view of permissible judicial review of the proclamations, endorsing judicial review of discretionary presidential decisions "where the authorizing statute or another statute places discernible limits on the President's discretion."[34] In that circumstance, "[c]ourts remain obligated to determine whether statutory restrictions have been violated."[35] The Court found this doctrine applicable to claims challenging Antiquities Act proclamations: "In reviewing challenges under the Antiquities Act, the Supreme Court has indicated generally that review is available to ensure that the Proclamations are consistent with constitutional principles and that the President has not exceeded his statutory authority."[36] Thus, the court's language approves judicial review of claims alleging that an Antiquities Act proclamation is unconstitutional or that the proclamation violated the Antiquities Act or any other applicable federal statute.

However, the court declined to consider any statutory claim in the case before it, finding that the plaintiff had failed to allege facts sufficient to support a constitutional or statutory claim.[37] Stating that "the court is necessarily sensitive to pleading requirements where, as here, it is asked to review the President's actions under a statute that confers very broad discretion on the President and separation of powers concerns are presented,"[38] the court determined that "[t]o warrant further review of the President's actions, Mountain States would have to allege facts to support the claim that the President acted beyond his authority under the Antiquities Act,"[39] and that it had failed to do so.

2. The same court issued its decision the same day in a companion case challenging the Grand Sequoia National Monument proclamation in 2000, *Tulare County v. Bush*.[40] The plaintiffs in that case asserted four violations of the Antiquities Act, one constitutional violation, and violations of three other federal statutes and a settlement agreement. Applying the review standards discussed in *Mountain States*, the court addressed the merits of the Antiquities Act claims and the constitutional claim, but rejected all of them.[41] The court rejected one claim under the NFMA on the merits, but refused to decide the other NFMA claim or the NEPA claim on the ground that neither statute contains a private right of action, the APA only authorizes review of "agency action," the President is not considered to be an "agency," and the allegations of unlawful action by subordinates were too vague.[42] Finally, the court rejected the settlement agreement claim as a matter of law based in part on insufficient factual allegations.[43]

3. In 2004 the district court issued its decision in *Utah Ass'n of Counties v. Bush*,[44] where the plaintiffs challenged the

1996 Grand Staircase-Escalante proclamation. The plaintiffs presented two constitutional challenges to the Antiquities Act: delegation in violation of Congress' duty to dispose of public lands under the Property Clause,[45] (a two-part claim); and violation of the Spending Clause.[46] They also asserted that the Grand Staircase-Escalante proclamation violated four statutes (the Wilderness Act; NEPA; FLPMA; and the Federal Advisory Committee Act (FACA)[47]) and one executive order (Executive Order 10355,), as well as the Antiquities Act itself.

The district court determined that it had authority to rule on the constitutional claims, and rejected both claims on the merits.[48] For the NEPA, FLPMA and FACA claims, the court determined, as in *Tulare County*, that no judicial review of the claims was permissible because the statutes contain no private right of action, the APA only authorizes review of "agency action" and the President is not considered to be an "agency."[49] For the Wilderness Act claim, the court did not choose to dispose of it on the reviewability ground, but instead ruled that the Wilderness Act does not apply to the President but only to federal "agencies."[50] As to the violation of the executive order, the court examined the merits of the claim and seemingly rejected it before determining that the court had no authority to enforce an executive order.[51]

The court also rejected the claim of violation of the Antiquities Act, adopting a review standard narrower than that articulated by the D.C. Circuit in *Mountain States*. The court held that it could review an exercise of discretion by the President but could do no more than "ascertain[] that the President in fact invoked his powers under the Antiquities Act."[52] This amounted to a simple determination that the President had claimed he was acting under the Antiquities Act.[53] The court said it could go no farther to consider the wisdom of the President's action under the statute.[54]

Strategic Conclusions and Recommendations for Future National Monument Litigation

Several strategic conclusions and recommendations emerge from these decisions:

1. Constitutional claims should not be pursued. One compelling conclusion is that constitutional challenges to the Antiquities Act have little chance of succeeding, and may act as dead weight to sink more meritorious statutory claims. It clearly seems far too late to argue successfully that Congress cannot enact a statute delegating its authority to the President where, as the D.C. Circuit found in *Mountain States*, the statute "includes intelligible principles to guide the President's actions."[55]

2. The APA does not permit judicial review of actions taken by the President. "The actions of the President . . . are not reviewable under the APA. . . ."[56] Since the Antiquities Act expressly assigns national monument decisions to the President, the APA is simply not available as a source of judicial review.

3. Asserting an APA claim against an inferior officer is unlikely to serve as a stand-in for a claim against the President. One technique for skirting the APA's omission of judicial review against the President is to assert the legal challenges to the monument designation against some inferior officer at an agency that is subject to APA review. The *Tulare County* court did not reject the potential for such a claim to be asserted, but in that case turned back an effort to sue low level foresters under the APA because "the complaint does not identify these foresters' acts with sufficient specificity to state a claim."[57] In *Utah Ass'n of Counties*, the court rejected the attempt to challenge agency recommendations to the President prior to a national monument proclamation on the ground that a recommendation is not judicially reviewable final agency action.[58]

In neither case did the plaintiffs challenge any specific agency action implementing the proclamation. Yet it is not clear that such an approach would succeed. In *Department of Transportation v. Public Citizen*,[59] the Supreme Court determined that an agency implementing a presidential directive was not required to study the environmental effects of the directive because the agency was powerless to reverse the directive regardless of its environmental effects. The same logic could preclude judicial review of an agency's implementation of a presidential order, such as a national monument proclamation, that it is powerless to reverse.

Even if a court were to find that an implementing agency official had violated NEPA, NMFA, FLPMA, or some other federal statute after the proclamation, it seems doubtful that the court would be empowered to set aside the presidential proclamation itself, although an injunction might bar some implementation of the proclamation. The proclamation would remain in effect permanently, which is a far less satisfactory outcome than an order setting the proclamation aside.[60]

4. Non-statutory review of Antiquities Act violations is available. While the APA is not available, non-statutory review of claims based on a violation of the Antiquities Act appears viable. In fact, embracing the existence of "intelligible principles" within the authority delegated by Congress may strengthen the reviewability of statutory claims because, as the D.C. Circuit held in *Mountain States*, non-statutory (or "*ultra vires*") judicial review of presidential action is permitted "where the authorizing statute or another statute places discernible limits on the President's discretion."[61] It could be argued that the "intelligible principles" needed for a constitutional delegation of congressional authority necessarily constitute the "discernible limits on the President's discretion" that permit judicial review of presidential action.

The language in the Antiquities Act strengthens the argument for "discernible limits on the President's discretion." The statutory direction in 16 U.S.C. §431 has two separate components: the first is the power of the President to "designate . . . objects . . . to be national monuments." While the President is expressly allowed to exercise this power "in his discretion," his power is limited to "historic landmarks, historic and prehistoric structures, and other objects of historic or scientific interest that are situated upon the lands owned or controlled by the Government of the United States," which certainly appears to be a "discernible limit" on his discretion.

The second power delegated to the President is that the President "may reserve as a part thereof parcels of land, the limits of which in all cases shall be confined to the smallest area compatible with proper care and management of the objects to be protected." Even with the word "may," this language is even

more clearly a "discernable limit" on the President's authority because this delegation does not contain permission for the President to act "in his discretion." The structure of the sentence clearly shows that "in his discretion" applies to the designation authority but not the reservation authority.

The omission of the modifying phrase "in his discretion" for the reservation authority, immediately following the use of that phrase for the designation authority, implies under standard rules of statutory interpretation that Congress did not intend the President to exercise his reservation authority "in his discretion" but rather in accordance with the statutory limit of a reservation to "the smallest area compatible with proper care and management of the objects to be protected."[62]

It would follow then that judicial review of the less discretionary reservation decision should be more exacting than review of the more discretionary action of designating a monument. In line with this reasoning, in *Tulare County* the court rejected a challenge to a reserve designation not because the decision was unreviewable but because "the complaint fails to identify the improperly designated lands with sufficient particularity to state a claim."[63] "Insofar as Tulare County alleges that the Monument includes too much land, i.e., that the President abused his discretion by designating more land than is necessary to protect the specific objects of interest, Tulare County does not make the factual allegations sufficient to support its claims."[64]

This reasoning is beneficial to proclamation opponents because the principal impact of a national monument proclamation is likely to result from the reservation of land within the monument rather than the designation itself; if the designation resulted in no change in on-the-ground management, there would be little controversy over these decisions.[65]

A court determining the presence or absence of "discernible limits" in the Antiquities Act could draw upon a well-trodden body of law distinguishing legislative standards to a federal agency that translate into reviewable action from those that are "committed to agency discretion" under the APA, U.S.C. §701(a)(2), and therefore unreviewable. There the controlling principle is that "review is not to be had if the statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion."[66] Courts have found reviewable action in statutes far less constraining than the words of the Antiquities Act.[67] The APA cases are consistent with allowing non-statutory review of the President's exercise of his Antiquities Act powers even though the reservation power uses the word "may."[68]

5. There is a heightened pleading requirement for non-statutory review of the President's decision to create a national monument. The pleading requirement announced by the D.C. Circuit in *Mountain States* and *Tulare County* is much more demanding that the normal pleading requirements under the Federal Rules of Civil Procedure, which even under recent Supreme Court decisions requires nothing more than "enough facts to state a claim to relief that is plausible on its face."[69]

A viable Antiquities Act claim against an overly broad designation or reserve will have to allege precisely where and why particular reserved areas do not qualify under the Antiquities Act. The complaint must "identify the improperly designated lands,"[70] must describe in detail which areas that were included in the reservation should not have been included, and where a claim is that areas within the designation "lack scientific or historical value,"[71] must support that claim with specific factual allegations. Notice pleading is not legally sufficient under the Antiquities Act, at least according to the D.C. Circuit.

6. Non-statutory review is narrower than APA review—but still potent. The absence of APA review of Presidential actions may or may not significantly limit non-statutory judicial scrutiny of those actions under the *ultra vires* doctrine. In *Mountain States*,[72] the D.C. Circuit described *ultra vires* judicial review as encompassing three categories of claims: constitutional claims; claims of violation of the statute under which the challenged action was taken; and claims of violation of other statutes.[73] Those three categories in fact constitute a fair proportion of all APA claims, although omitting the "arbitrary and capricious" review[74] and the suite of "failure to explain adequately" arguments permitted under *Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co.*[75] While there is no requirement for the agency to produce an administrative record for non-statutory review, and the legal standard to be applied by the court is not clear, these factors do not clearly favor either side.

7. A second alternative to APA review may be available. Another way to overcome an APA bar to a claim against the President is for a proclamation opponent to violate the terms of a proclamation, force the government to file criminal charges, and invoke the illegality of the proclamation decision as a defense to the criminal charges. In fact, this is precisely the way that two of the reported Antiquities Act cases—*Cameron v. United States*[76] and *Cappaert v. United States*[77]—reached court. Challenging the validity of a statute or act underlying a criminal charge is a permissible defense for a criminal defendant.[78] No congressional authorization is required to challenge the validity of a statute or act in this manner.

8. Non-reviewability is not the same as legality. Even where the absence of APA review (or non-statutory review) may bar a claim, that bar should not be confused with a finding that the challenged action is lawful. From a judge's standpoint, a jurisdictional dismissal resolves a claim as well as a merits decision, but from the public's standpoint, there is (or should be) a fundamental difference between a court ruling that it cannot decide a claim and a court ruling that the claim has no legal merit. A jurisdictional dismissal may simply allow unlawful action to continue because the courts have no power to stop it.

9. A claim that an Antiquities Act proclamation violates another federal statute requires a determination of what the President's duties are under that statute, an area of law that remains largely unexplored. Perhaps the most profound and still unresolved question raised by Antiquities Act litigation is the relationship between presidential power and statutory authority that Congress assigned to an executive branch agency or officer. Does a statutory directive to "the Secretary" to perform or avoid

an act (a common statutory phrase) apply to the President? If the President cannot perform an act assigned to "the Secretary," or compel the Secretary to perform that act in a particular manner, how can the President perform his constitutionally-mandated duty in Art. II, Sec. 3, Cl. 4 to "take care that the laws be faithfully executed," and who is responsible for seeing that the Secretary faithfully executes the laws? Conversely, if the Secretary's duties automatically apply to the President, can the President order the Secretary to violate one federal statute in order to implement another federal statute (or for any other reason)?

The D.C. Circuit offered a partial answer in a case considered seminal in the development of law under the Freedom of Information Act (FOIA)[79]: *Soucie v. David*.[80] The court addressed the situation where the President, who by statute is not subject to FOIA, had directed an inferior official, who was subject to the law, not to release a Report that FOIA required to be released.

> [C]ourts have power to compel subordinate executive officials to disobey illegal Presidential commands. If nondisclosure of the . . . Report is not supported by a statutory exemption or a constitutional executive privilege, the Freedom of Information Act requires issuance of an injunction to compel the [Office of Science and Technology (OST)] to release the Report, whether the refusal to disclose is attributable to the OST or to the President.[81]

Under this rule, the President cannot order an agency official to violate a statute. The President is not above the law, even if the President is exempt from the law.

These questions relate specifically to the interplay of the Antiquities Act, enacted in 1906, and the various environmental laws (e.g., NEPA, FLPMA, NFMA, the Wilderness Act, Clean Water Act) that have been the source of a statutory violation claim in an Antiquities Act case. A later-enacted statute can impliedly amend an earlier statute, but only if the two laws "are in 'irreconcilable conflict,'" and Congress' intention to do so is "clear and manifest."[82] Absent such a clear conflict, the later-enacted statute should be construed to operate in harmony with the earlier law.[83] Without implied repeal, a later-enacted law cannot alter an existing statutory mandate to take an action if specified criteria are met. Yet a later-enacted law can permissibly add additional requirements to a statute that merely specifies minimum criteria for the action,[84] so that both statutes have effect.[85]

In this case, the Antiquities Act sets two minimum criteria (presence of certain "objects" and reserves established as small as possible) for the designation of a national monument, but does not require the President to create a monument if the two statutory criteria are met. Nothing prohibits the President from conducting an environmental review before making his decision. Thus, the President could comply, for example, with both NEPA and the Antiquities Act simply by preparing a legally adequate environmental impact statement before making a monument proclamation. The President could also comply with NFMA, FLPMA, and the Wilderness Act by following the procedural and substantive direction of those laws before exercising Antiquities Act authority.

It is true, as noted above, that NEPA compliance is not required before an agency complies with an order from the President because the agency has no discretion to disregard the Presidential order and the environmental review has no purpose.[86] But that doctrine does not excuse the President from complying with procedural or substantive environmental laws before making a decision or issuing an order to an agency. Where a statute imposes such a duty on the President, and performing that duty is not inconsistent with an earlier statute authorizing the decision or order, the President must comply with both laws.

So the issue becomes one of discerning what burdens a particular statute imposes on the President, and how those burdens interact with the President's Antiquities Act powers. An initial consideration of these questions for the relevant statutes yields some tentative observations:

1. NEPA. Title 42 U.S.C. §4332(1) states: "The Congress authorizes and directs that, to the fullest extent possible: (1) the policies, regulations, and public laws of the United States shall be interpreted and administered in accordance with the policies set forth in this chapter . . . ." This direction, which applies to the Antiquities Act as one of the "public laws of the United States," extends to the President. In contrast, 42 U.S.C. §4332(2) imposes specific environmental review duties on "all agencies of the Federal Government"—a formulation that has been interpreted to exclude the President. Thus, NEPA could reasonably be construed not to impose specific EIS-writing obligations on the President, but to require the President to interpret and administer the Antiquities Act in accordance with NEPA's policies.[87]

2. Wilderness Act. The Wilderness Act contains three categories of direction: to the world at large;[88] to the agencies responsible for managing the designated areas;[89] and to the President.[90] Further, the statute specifically directs that it "shall in no manner lower the standards evolved for the use and preservation of such park, monument, or other unit of the national park system" in accordance with a set of enumerated statutes including the Antiquities Act.[91]

Plainly the Wilderness Act applies to national monuments, and just as plainly the Wilderness Act is not permitted to "lower the standards" developed at the national monuments under the Antiquities Act. That duty applies to the President, which requires the President to determine and understand what the existing "standards" are at each national monument so as to assure no "lowering" of those standards. By expressly forbidding "lowering the standards" set under the Antiquities Act, the statute impliedly allows the Wilderness Act to modify any other duty under the Antiquities Act (i.e., allowing a power project that is not currently permitted if the President determines the power project will not "lower the standards" at the monument). So to some extent the President is required to follow both the Antiquities Act and the Wilderness Act, and to that extent the Wilderness Act impliedly amends the Antiquities Act. This could create a situation where a national monument is proclaimed with use conditions that conflict with the Wilderness Act, either by allowing activities barred by that Act or by barring activities allowed by that Act (e.g., a

power project previously approved by the President himself). A non-statutory claim against the President should be available to remedy a Wilderness Act violation resulting from a national monument designation.[92]

3. NFMA. The NFMA imposes its duties on the Secretary of Agriculture. However, 16 U.S.C. §1606 (a) imposes on the President the duty to submit an annual "Statement of Policy" for Forest Services lands to Congress along with its annual budget request, and thereafter to "carry out programs" under the Statement of Policy.

4. FLPMA. FLPMA imposes its duties principally on the Secretary of Interior but in some cases on the Secretary of Agriculture. The President's only duty is to submit wilderness recommendations to Congress.[93]

These two statutes can be considered together, as they have similar structures and purposes. In NFMA and FLPMA Congress has given the Secretaries of Interior and Agriculture statutory authority to implement land management programs. The relationship between a cabinet secretary and the President is not generally spelled out in any statute; rather, it seems to derive inferentially from Art. II, Sec. 1, Cl. 1's statement that: "The Executive Power shall be vested in a President of the United States of America," and from the President's duty in Art. II, Sec. 3, Cl. 4 to "take care that the laws be faithfully executed." Secretaries work for the President, who can give them orders and fire them if they fail to follow those orders, and reassign their duties to another department or official if he decides to do so.[94] The President can delegate his authority to the Secretaries, but remains responsible for their conduct.[95] It would seem natural that the President can tell the Secretaries how to perform the duties assigned to them by Congress (executive power is vested in the President, not any subordinate), or perform a duty himself if he deems it necessary. Yet to perform certain statutory duties the Secretaries must comply with procedural and substantive requirements under NFMA or FLPMA. If the President is not required to comply with those same requirements before acting, then the President could allow his Secretaries to evade the land management and environmental laws simply by taking decision-making authority from the Secretaries and making the decisions himself. Under the Antiquities Act, one court has held that the President's authority to include management restrictions in a monument proclamation arises from FLPMA, necessarily implying that FLPMA grants power to the President, although it purports to grant authority to "the Secretary."[96]

The President-is-not-covered concept appears to be an interpretation of this complex of statutes which should be avoided if possible.[97] The President should not be able to perform an act in a procedural or substantive manner proscribed for the subordinate who is assigned the statutory duty to perform the act. Another interpretation of these laws seems necessary to avoid this problem. The logical alternative interpretation is that when NMFA, FLPMA, the Wilderness Act and other statutes assign duties to a "Secretary," those duties also apply to the President to the extent the President involves himself (either by direction or "recommendation" enforced by threat of job loss) in decisions with consequences relevant to those statutes.

5. ESA. Unlike the statutes named above, the ESA contains its own authorization for citizen suits to enforce aspects of the statute,[98] and reliance on the APA for judicial review is unnecessary. The ESA imposes some duties on agencies, e.g., the consultation requirements in 16 U.S.C. §1536(a)(2), and other duties on "any person," e.g., the prohibition on taking an endangered species in 16 U.S.C. §1538. The President is undoubtedly a person under the latter provision, and a citizen suit is available to enjoin the President from unlawfully taking an endangered species.[99] Thus, should a national monument designation threaten to take an endangered species, any citizen could sue the President to enjoin the designation on that ground.[100]

6. Clean Water Act. The Clean Water Act has a citizen suit provision similar to that in the ESA, permitting any citizen to sue "any person" who is violating any standard or order issued under that law.[101] Suit against the President appears to be permitted under this statute if a national monument designation were to cause such a violation.

Conclusion

The President is not immune from judicial review of a national monument proclamation. A court can determine if the proclamation violates the Constitution, the Antiquities Act, or another federal statute that applies directly or indirectly to the President in a manner that limits his authority under the Antiquities Act. Recent judicial decisions upholding Antiquities Act proclamations can be viewed as providing a road-map to successful prosecution of such claims, although highlighting the narrowness of the path to judicial success. Proclamation opponents should not be unduly discouraged by the results of these cases, but should instead focus on the courts' consistent acknowledgement that valid claims against a national monument proclamation can be asserted.

Endnotes

1 16 U.S.C. §§ 431-433.

2 *See* U.S. House of Representatives, Natural Resources Committee Republicans, Ranking Member Hastings Urges Democrat Majority to Embrace Transparency, Bring Resolution of Inquiry on National Monument Documents for Vote in Full House (2010) (including attached document).

3 16 U.S.C. §§ 431.

4 *See* Cong. Research Serv., Grand Staircase-Escalante National Monument, Report 98-993 (December 21, 1998); Nat'l Park Serv., National Monument Proclamations under the Antiquities Act, http://www.nps.gov/history/history/hisnps/npshistory/monuments.htm.

5 Pub. L. 96-487 (1980).

6 16 U.S.C. § 3213 (1980); Cong. Research Serv., National Monuments and the Antiquities Act, Report RL30528 (2000). An earlier controversy arose in 1943 when President Roosevelt established a national monument in the area of Jackson Hole, Wyoming in order to receive a gift of land from the Rockefeller family. Congress reacted unfavorably to the controversial decision, prohibiting any future monument designations in Wyoming without congressional approval. 16 U.S.C. §431a.

7 Cong. Research Serv., National Monument Issues, at CRS-2 (2006).

8 *Id*. at CRS-5-6.

9 Mountain States Legal Found. v. Bush, 306 F.3d 1132 (D.C. Cir. 2002), *cert. denied,* 540 U.S. 812 (2003); Tulare County v. Bush, 306 F.3d 1138 (D.C. Cir. 2002), *cert. denied,* 540 U.S. 813 (2003); Utah Ass'n of Counties v. Bush, 316 F.Supp.2d 1172 (D. Ut. 2004), *appeal dismissed*, 455 F.3d 1094 (10th Cir. 2006).

10 Cong. Research Serv., Federal Land Ownership: Current Acquisition and Disposal Authorities 1, 11 (2007).

11 43 U.S.C. §§ 1701 *et seq.*

12 16 U.S.C.§§ 1600 *et seq.*

13 42 U.S.C. § 4332 *et seq.*

14 16 U.S.C. §§1531 *et seq.*

15 16 U.S.C.A. §§ 1131 *et seq.*

16 16 U.S.C. §§1271 *et seq.*

17 33 U.S.C. §§ 1251 *et seq.*

18 Cong. Research Serv., National Monument Issues, at CRS-5-6 (2006); Cong. Research Serv., National Monuments and the Antiquities Act, Report RL30528 (2000) (President Carter's Wrangell-St. Elias National Monument proclaimed in 1978 contained 10,950,000 acres.); Utah Ass'n of Counties v. Bush, 316 F.Supp.2d 1172, 1176 (D. Ut. 2004) (Grand Staircase-Escalante monument contains 1.7 million acres.); Proclamation No. 7265, 65 Fed. Reg. 2825, 2825-26 (Jan. 18, 2000) (Grand Canyon-Parashant National Monument in Arizona comprises 1,014,000 acres of land.).

19 Many of President Clinton's monument proclamations provided that "all motorized and mechanized vehicle use off road will be prohibited, except for emergency or authorized administrative purposes." *See, e.g.*, Proclamation No. 7265, 65 Fed. Reg. 2825, 2825-26 (Jan. 18, 2000) (Grand Canyon-Parashant National Monument); Proclamation No. 7397, 66 Fed. Reg. 7354 (Jan. 22, 2001) (Sonoran Desert National Monument in Arizona comprising 486,149 acres, with the same prohibition on vehicle use); Proclamation No. 7374, 65 Fed. Reg. 69,227 (November 9, 2000) (proclaiming the Vermillion Cliffs National Monument in Arizona with 293,000 acres, with the same vehicle prohibition).

20 Klein, *Preserving Monumental Landscapes Under the Antiquities Act*, 87 Cornell L. Rev. 1338, 1388 (2002).

21 16 U.S.C. §431.

22 *See supra* note 4.

23 252 U.S. 450 (1920).

24 *Id*. at 455-56.

25 58 F. Supp. 890 (D. Wy. 1945).

26 *Id*. at 895-96.

27 President Truman's proclamation of the Devil's Hole national monument in 1952 triggered a legal battle twenty years later over the inclusion of water rights within the monument, with the Supreme Court determining that the proclamation included appurtenant unappropriated water within the monument area. Cappaert v. United States, 426 U.S. 128 (1976).

28 National Park Service, National Monument Proclamations under the Antiquities Act, http://www.nps.gov/history/history/hisnps/npshistory/monuments.htm.

29 Alaska v. Carter, 462 F.Supp. 1155, 1159 (D. Alaska 1978).

30 *See* note 5 at CRS-5.

31 306 F.3d 1132.

32 U.S. Const. art. IV, § 3, cl. 2.

33 Mountain States Legal Found. v. Bush, 306 F.3d 1132, 1134 (2002).

34 *Id*. at 1136.

35 *Id*.

36 *Id*.

37 *Id*.

38 *Id*. at 1137.

39 *Id*.

40 306 F.3d 1138 (2002).

41 *Id*. at 1141-43.

42 *Id*. at 1143.

43 *Id*. at 1143-44.

44 316 F.Supp.2d 1172 (D. Utah 2004).

45 U.S. Const. art. IV, § 3, cl. 2.

46 U.S. Const. art. I, § 8, cl. 1.

47 5 U.S.C. app. 2.

48 Utah Ass'n of Counties v. Bush, 316 F.Supp.2d 1172, 1184 (D. Utah 2004).

49 *Id*. at 1194-95.

50 *Id*. at 1194.

51 *Id*. at 1200.

52 *Id*. at 1183.

53 *Id*. at 1186.

54 *Id*.

55 Mountain States Legal Found. v. Bush, 306 F.3d 1132, 1137 (2002).

56 Dalton v. Specter, 511 U.S. 462, 470 (1994) (quoting Franklin v. Massachusetts*,* 505 U.S. 788, 800-01 (1992)).

57 Tulare County v. Bush, 306 F.3d 1138, 1143 (2002).

58 *Utah Ass'n of Counties*, 316 F.Supp.2d at 1188-89.

59 541 U. S. 752 (2004).

60 Another way to overcome an APA bar to a claim against the President is for proclamation opponents to shift the debate from the judicial branch to the legislative branch through proceedings for impeachment and removal. Congress can predicate impeachment on its own determination that a violation of a statute or constitutional provision has occurred; no prior judicial decision is required.

61 Mountain States Legal Found. v. Bush, 306 F.3d 1132, 1136 (2002).

62 "[W]here Congress includes particular language in one section of a statute but omits it in another section of the same Act, it is generally presumed that Congress acts intentionally and purposely in the disparate inclusion or exclusion." Kucana v. Holder, 130 S. Ct. 827, 838 (2010) (citation omitted). This presumption is stronger when the comparison is between two subsections of the same section. Chesnut v. Montgomery, 307 F.3d 698, 702 (8th Cir. 2002).

63 Tulare County v. Bush, 306 F.3d 1138, 1142 (2002).

64 *Id*.

65 The designation itself undoubtedly would have some impact even without a reserve insofar as federal land management agencies might feel constrained to adopt land management measures to protect a designated monument even where no reserve is created. Any opposition to such land management measures could be expressed through a legal challenge to the land management measure against the managing agency, not through a challenge to the President's Antiquities Act decision.

66 Heckler v. Chaney, 470 U.S. 821, 830 (1985).

67 Cody v. Cox, 509 F.3d 606, 610 (D.C. Cir. 2007) (holding that a "high quality and cost-effective" requirement for health care is sufficient to permit judicial review); Inova Alexandria Hosp. v. Shalala, 244 F.3d 342, 348 (4th Cir. 2001) (stating that "courts routinely conclude that judicial review is available notwithstanding statutory language that seemingly allows for unlimited discretion," and citing cases allowing review over statutory decisions involving the word "may"); Bd. of Trustees of Knox County (Ind.) Hosp. v. Sullivan, 965 F.2d 558, 562, (7th Cir. 1992), *cert. denied*, 506 U.S. 1078 (1993) (finding that the phrase in Medicare statute "deem necessary or advisable in the interest of the United States" was found to be a sufficient standard to support review).

68 The court relied on the APA "committed to agency discretion by law" cases in determining that it had authority to review a claim that federal agency action violated a prescription in a monument proclamation. W. Watersheds Project v. Bureau of Land Mgmt., 629 F. Supp. 2d at 968.

69 Bell Atl. Corp. v. Twombly, 550 U.S. 544, 570 (2007); Ashcroft v. Iqbal, 129 S. Ct. 1937 (2009) (extending *Twombly* to all civil claims).

70 Tulare County v. Bush, 306 F.3d 1138, 1142 (2002).

71 *Id*.

72 Mountain States Legal Found. v. Bush, 306 F.3d 1132 (2002).

73 *Id*. at 1136. But note that the district court in *Utah Ass'n of Counties* applied a much narrower "facial-only" non-statutory review of presidential action, as had the district court in *Tulare County*, the decision reversed in the D.C. Circuit case discussed in the text.

74 "[T]he agency must examine the relevant data and articulate a satisfactory explanation for its action including a rational connection between the facts found and the choice made. . . . In reviewing that explanation, we must consider whether the decision was based on a consideration of the relevant factors and whether there has been a clear error of judgment." Motor Vehicle Mfrs. Ass'n of U.S. v. State Farm Mut. Auto. Ins. Co., 463 U.S. 29, 43 (1983).

75 463 U.S. 29 (1983). In *Tulare County*, the same three judges seemed to contradict their own *Mountain States* decision, ruling that two of the statutory claims (under NFMA and NEPA) were not justiciable because the APA does not permit judicial review of presidential action. *Tulare County*, 306 F.3d at 1143. The question is not so much whether the court's interpretation of the APA is correct, but why the court even bothered to address the viability of an APA claim under those statutes when under *Mountain States* equivalent *ultra vires* review of those claims was available outside the APA. The answer may simply be that the claims pleaded in the complaint were APA claims rather than *ultra vires* claims.

76 252 U.S. 450 (1920).

77 426 U.S. 128 (1976).

78 United States v. Lopez, 514 U.S. 549 (1995).

79 5 U.S.C. §552.

80 448 F.2d 1067 (D.C. Cir. 1971).

81 *Id*. at 1072 n.12; *see* Kemet Elecs. Corp. v. Barshefsky, 976 F. Supp. 1012, 1025 (C.I.T. 1997) ("[T]he court may review Presidential action to determine if it complies with a statute and the court may order the [United States Trade Representative], as the President's trade agreement negotiating agent, and the Commissioner of Customs to comply with statutory limitations.").

82 Nat'l Ass'n of Home Builders v. Defenders of Wildlife, 551 U.S. 644 (2007) (citations and quotations omitted).

83 *Id*. at 662.

84 *Id*. at 664.

85 "[S]ubsequent statutes concerning the use and management of federal land, including FLPMA, NFMA, the Taylor Grazing Act of 1934, 43 U.S.C. § 315, NEPA, the Endangered Species Act of 1973, 16 U.S.C. §§ 1531 et seq. , and the Public Rangelands Improvement Act of 1978, 43 U.S.C. §§ 1901-1908, do appear to place discernible limits on the President's apparent discretion to issue directives in proclamations for the use and management of federal land in national monuments created pursuant to the Antiquities Act." W. Watersheds Project v. Bureau of Land Mgmt., 629 F. Supp. 2d 951, 954-65 (D. Ariz. 2009).

86 Dep't of Transp. v. Pub. Citizen, 541 U.S. 752 (2004).

87 This was the interpretation adopted in *Alaska v. Carter*, 462 F. Supp. 1155, 1159-60 (D. Alaska 1978) ("While the declaration of policy in NEPA requires the full consideration of environmental consequences in all of the federal government's activities, 42 U.S.C. §4331, the Act limits the 'action-forcing' impact statement process to 'agencies of the Federal government'), as well as *Utah Ass'n of Counties*, 316 F. Supp. 2d 1172, 1188 (D. Utah 2004). *See* Natural Res. Def. Council, Inc. v. U.S. Dep't of State, 658 F. Supp. 2d 105, 112 (D.D.C. 2009) ("Not even the EIS requirement of NEPA applies to the President.").

88 16 U.S.C. § 1133(c) and parts of (d).

89 16 U.S.C. § 1133(b).

90 16 U.S.C. § 1133(d)(4) (pertaining to approval of water and power projects).

91 16 U.S.C. § 1133(a)(3).

92 The court so held in *Utah Ass'n of Counties,* 316 F. Supp. 2d at 1192.

93 43 U.S.C. § 1782(b).

94 5 U.S.C. §§ 901 *et seq.*

95 3 U.S.C. § 301(2).

96 W. Watersheds Project v. Bureau of Land Mgmt., 629 F. Supp. 2d 951, 956 (D. Ariz. 2009) (proclamation enforceable because it is based on statutory authority (FLPMA)).

97 Griffin v. Oceanic Contractors, Inc., 458 U.S. 564, 575 (1982).

98 16 U.S.C. § 1540(g).

99 16 U.S.C. § 1540(g)(1)(a).

100 The idea that a federal regulatory action could cause an unlawful take of an endangered species is not far-fetched. In *Defenders of Wildlife v. Administrator, Environmental Protection Agency*, 882 F.2d 1294, 1300-01 (8th Cir. 1989), the court held that a federal action continuing registration of a pesticide could be considered the cause of take resulting from use of the pesticide. Other courts have held that state regulatory actions that start a chain of events leading to a take of an endangered species are unlawful under the ESA. Strahan v. Coxe, 127 F.3d 155, 158, 163 (1st Cir. 1997), *cert. denied*, 525 U.S. 830 (1998).

101 33 U.S.C. § 1365(a).

Federalism & Separation of Powers

Legal and Logistical Ramifications of the National Popular Vote Plan

*By Tara Ross**

The nation's attention has been focused on several potential crises in the past few months: The economy. Health care. Troubled auto companies. The manner in which America addresses any one of these issues could impact the identity of the country for decades to come. Will America be a country of individual freedom and private entrepreneurship? Or will Americans rely more heavily on their government for sustenance? The issues to be decided are many and important. Why turn attention now to other, less exciting topics such as the Electoral College? Surely that discussion can be saved for another day. Or can it?

The answer, unfortunately, is "no." Americans must focus on this issue now, or they will find that they've missed the opportunity to influence a matter currently being considered by state legislators. These legislators are being lobbied to pass an idea promoted by a California-based group, National Popular Vote Inc. (NPV).[1] If the legislation is approved, the Electoral College will essentially be eliminated, replaced with a nationwide popular election.

NPV disputes such a characterization of its legislation. The genius of the plan, one of its advocates notes, is "that it offers America a way to reach true democracy in our presidential elections not by eliminating the Electoral College but by reforming our use of it."[2] NPV relies heavily on the states' role in our system. The Constitution provides: "Each State shall appoint, in such Manner as the Legislature thereof may direct, a Number of Electors . . . ."[3] Currently, most states allocate their electors to the winner of the statewide popular vote. NPV proposes, instead, that each state should allocate its electors to the winner of the national popular vote. If states with a majority of electors (currently 270) agree to the plan, the presidential election system will operate as a national popular referendum rather than a federalist, state-by-state process. To ensure that no state is left alone in its decision, NPV operates through an interstate compact. The compact goes into effect only when a critical mass of states agrees to join.

As this piece goes to press, five states have agreed to join the compact: Hawaii, Illinois, Maryland, New Jersey, and Washington (sixty-one electoral votes total).[4] Three other state legislatures approved the plan, but the governors vetoed it: California, Rhode Island, and Vermont (sixty-two electoral votes total). The Rhode Island legislature subsequently reconsidered the NPV plan, but House members apparently had a change of heart. The second time around, NPV was voted down before reaching the governor's desk.

In their book, *Every Vote Equal*,[5] NPV's founders argue that their plan is necessary because every vote is not equal under our current system. They contend that votes cast outside of battleground states are "worthless," causing some voters to be ignored. They dislike the fact that national popular vote losers can be elected to the presidency, and they feel that the Electoral College generates artificial election crises. NPV, they argue, will cure these inequities even as it leaves each state's current internal procedures intact. They dismiss the concerns of Electoral College advocates that the current system serves valuable purposes in a republic—especially one as large and diverse as America.

This author has argued elsewhere that the benefits of the Electoral College far outweigh its disadvantages and that it continues to serve these purposes even when a popular vote loser is elected to the presidency.[6] This article will not re-debate those points. Instead, it will discuss several practical and legal issues that have often been left unaddressed when state legislatures consider NPV: What ramifications follow if one allegedly national election is conducted under fifty-one different sets of local election laws? Does NPV's use of an interstate compact require congressional approval? Does Article V of the Constitution provide any impediment to NPV? How does the definition of "Legislature" in Article II impact the manner in which NPV may be enacted? These issues would not exist if anti-Electoral College advocates pursued their plan through a constitutional amendment, rather than the interstate compact that they have proposed. Indeed, some of the consequences of NPV are so serious that Professor Akhil Amar—among the first to imagine a NPV-like scenario—once stated that the logistical ramifications "could be a real nightmare."[7]

This is one nightmare that America should strive to avoid at all costs.

Logistical Issues Involved in the NPV Plan

The current presidential election process is a unique blend of federalist and democratic principles. America holds fifty-one completely separate, purely democratic elections each presidential election year (one in each of the states, plus one in the District of Columbia). Local election laws impact the manner in which any one of these elections is held, but any differences among the states' election codes don't matter. The unique laws of any particular state impact only voters within that state. The country holds fifty-one completely separate presidential elections, and it achieves fifty-one different sets of results. Each state's single goal is to select a slate of electors that will represent it in the later, national election among the states. NPV would entirely change this system. America would still hold fifty-one completely separate elections, but NPV would attempt to derive one single result from these various election processes. Suddenly, internal variances among states' processes—previously irrelevant—would begin to matter

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a great deal. NPV could avoid these problems if it instead sought change through a constitutional amendment. Such an amendment would help establish one set of national laws to govern one national election.

Without this amendment, a few logistical problems will be unavoidable. Among the biggest of these will be the chaotic recounts that are virtually certain to ensue.[8] States have different criteria for what does (or does not) trigger recounts within their borders. These differences can and will cause many problems.

NPV's interstate compact requires the chief election official in each member state to "determine the number of votes for each presidential slate in each State of the United States and in the District of Columbia in which votes have been cast in a statewide popular election."[9] These votes are to be added together to determine which candidate won the "largest national popular vote total."[10] The official then certifies the appointment of the slate of electors associated with that "national popular vote winner."[11]

Sounds easy enough, but what if this calculation reveals that the national total is close—close enough to warrant a recount—but a recount can't be conducted because the margins in individual states are not close? Or perhaps a recount can be conducted in two or three states, but wide margins in the remaining states prevent the others from also participating in the recount. The three states conducting recounts may each have a different idea of how to count a hanging chad. Perhaps a fourth state would see what is going on and choose to conduct a recount that its statutes previously deemed optional. Maybe this fourth state has a different definition of "hanging chad," and its sole goal is to counteract the efforts of the other states. Logistically, such a situation is problematic. Legally, the situation might create equal protection claims. Some voters could be disenfranchised by the widely differing ideas of how to count a vote.[12]

NPV brushes off these serious questions. If a recount is needed, the authors of *Every Vote Equal* note, "the personnel and procedures for a nationwide recount are already in place because every state is always prepared to conduct a statewide recount after any election."[13] NPV has not addressed the problem inherent within its own statement. True, states have personnel and procedures in place for recounts—fifty-one of them. Fifty-one different statutory schemes can't govern one (allegedly) national election. The authors do not address this problem and instead assume that recounts won't be needed very often anyway. *Every Vote Equal* contends that "there would be less opportunity for a close election under nationwide popular election of the President than under the prevailing statewide winner-take-all system" because a "a close outcome is less likely in a single pool of 122,000,000 popular votes than in 51 separate pools each averaging 2,392,159 votes."[14] NPV may regret jumping to this conclusion so quickly. It is not safe to assume that recounts will be few and far between with a national popular vote system in place. To the contrary, there are at least two reasons to believe that recounts will become more frequent.

First, America's presidential campaigns would certainly change if the rules of the game change. In any game, rule changes regularly impact strategy, motivations, and incentives. In presidential elections, the changed rules of the game would almost certainly lead to the end of America's stable, two-party system.[15] Without the Electoral College and the winner-take-all allocation of electoral votes within states, there is a dramatically reduced disincentive to vote for third party candidates. A vote for Ross Perot or Ralph Nader is no longer "wasted." Instead, presidential campaigns would devolve into European-style, multi-candidate races. In the context of recounts, this is important. As more candidates enter the field, individual votes will necessarily be divided among an ever-increasing number of candidates. The result will be lower vote totals per candidate and an increased likelihood that two or more candidates will have close popular vote totals.

Second, the authors of *Every Vote Equal* do not adequately address the historical record. Even assuming, *arguendo*, that America maintains its relatively stable two-party system, past election results show that recounts would be more likely without the Electoral College. Popular vote totals are usually closer than electoral vote totals.[16] Of the twenty-eight elections held between 1900 and 2008, seventeen Presidents have been elected after winning the electoral vote by a margin of two hundred votes or more. (Only three elections during the same time period were won by fifty electoral votes or less.) These consistently wide margins of victory have come about despite the fact that the margin between the top two candidates in the popular vote was less than ten percent in sixteen of the twenty-eight elections held since 1900—and less than five percent in seven of these elections. Indeed, former FEC chairman Bradley Smith points out that recounts may have been necessary in as many as six presidential elections since 1880, if a national popular vote system had been in place.[17] That's nearly one out of every six elections! It is not safe to assume that recounts will be a rarity once NPV is in place.

Unfortunately, recounts are just the tip of the iceberg. NPV's member states can't force the other states to take any particular action—including a run-off if it is needed. Thus, note that NPV's compact awards the presidency to the candidate winning the "*largest* national popular vote total."[18] The compact does not require a majority winner. It does not even require a minimum plurality. Practically speaking, it cannot. Thus, with the NPV compact in place, a candidate could win with even a very small plurality, for example, fifteen or twenty percent of the nationwide vote.

But the logistical difficulties could get even worse. A participating state could be forced to award its entire slate of electors to a candidate who was not on its own ballot. Imagine, for instance, that Ron Paul qualifies for the ballot in Texas and obtains a winning plurality solely from Texas voters. Paul did not bother to qualify for the ballot in a place like New Jersey. Voters in that state did not have the chance to vote for—or against—him. Yet New Jersey would be forced to award its entire slate of electors to the choice of Texas voters. New Jersey probably did not nominate a slate of electors for Paul because he was not on its ballot. NPV's compact offers a solution, but it is doubtful that voters in New Jersey will like it. Paul would be entitled to personally appoint the fifteen electors who will represent New Jersey in the Electoral College vote.[19] In all

likelihood, he would select Texans to represent New Jersey in the presidential election so that he would not be undermined by a "faithless" elector who was determined to vote for the choice of New Jersey's voters.

There are other inconsistencies among states' ballots that would skew the election results. Some states allow felons to vote. Others do not. States differ in their requirements to qualify for the ballot. Inevitably, each state would have to abide by national election results derived from policies with which it disagrees. Moreover, states may differ in how they do (or don't) list electors on the ballot, and these differences can become irresolvable when attempting to produce one national tally. In 1960, for instance, Alabama voters cast ballots for individual electors, rather than presidential candidates. To make matters more confusing, the Democratic Party in Alabama nominated a split slate of electors. Five electors were pledged to vote for the eventual Democratic nominee, John Kennedy, but six electors were unpledged. (They ultimately cast their ballots for Harry F. Byrd.) Voters could not vote for eleven Kennedy electors, even if they wanted to. But they could vote for a pledged Kennedy elector and an unpledged Democratic elector simultaneously. Given the situation, the popular vote total in Alabama would have been impossible to definitively tabulate if NPV had been in place that year.

In fact, a state today could attempt to undermine NPV by deliberately recreating the 1960 situation.[20] Its legislature would simply replace the state's winner-take-all system with direct elections for individual electors. Just as in 1960, the NPV states would be unable to say which candidate won the "most" votes in that state. Their compact should fail because the national popular vote total is unknowable—although NPV advocates could conceivably seek to explicitly exclude such a state from the presidential election. Presumably, it would be politically difficult for them to take such action, however.

These or other problems could cause one state to pull out of the compact in violation of its terms. How would compliance be enforced? How much litigation would ensue before the presidential election could be resolved? Even if compliance can be enforced when a presidential election is pending, the compact allows states to withdraw before July 20 in a presidential election year.[21] Potentially, a wavering state or states could cause NPV's compact to bounce back and forth—in effect one year, but not the next. Perhaps the state would opt in and out based on its perception of whether the compact would play to its benefit in that particular presidential election year.[22] Consistency in America's presidential election system is impossible in such circumstances.

NPV proponents act as if they can successfully avoid the constitutional amendment process through their interstate compact. Their idea was admittedly imaginative, but it would create a whole host of logistical problems. These problems have as yet to be seriously addressed. Instead, NPV supporters continue to act as if one internally consistent nationwide outcome can be derived from fifty-one separate state and local processes.

The Use of an Interstate Compact

The legislation proposed by NPV relies on its use of an interstate compact. Approval of the legislation commits a state to the terms of the compact, but not until states holding a majority of electoral votes (270) have agreed to sign. Until then, each state maintains its status quo—usually a winner-take-all system within the state.

The compact grants comfort to those state legislators who generally like the idea of a national popular vote, but who don't want their states left out in the cold if other state legislatures choose not to join in the effort—or if they join, but then change their minds later. The compact ensures that participating states can act only when they are guaranteed the ability to do so in concert with other states.

Even NPV proponents sometimes concede that their use of a compact is a potential hindrance from a constitutional perspective. Article I, Section 10 of the Constitution provides that "No State shall enter into any Treaty, Alliance, or Confederation" and "No State shall, without the Consent of the Congress, . . . enter into any Agreement or Compact with another State."[23] The text would seem to be clear that some agreements (treaties) are completely forbidden and that others (agreements and compacts) are permissible only with congressional approval, but the Supreme Court has held otherwise. In the space of two written opinions, the Court changed the focus of the clause. Rather than evaluating permissibility v. non-permissibility, the Court now effectively assumes that all agreements among states are permissible. It considers only whether congressional approval is required.

The 1893 case of *Virginia v. Tennessee* was the first step down this road.[24] Virginia brought an action against Tennessee, seeking to have a boundary agreement nullified. Virginia claimed that Congress had never approved the agreement. The Court ultimately disagreed, finding that the agreement had indeed received congressional approval. It probably should have stopped there, but Justice Field, writing for the Court, decided to first expound on the meaning of the Compact Clause. His dictum eventually became the basis for modern jurisprudence on interstate compacts.

Justice Field reasoned that the constitutional provision could not possibly mean "*every* possible compact or agreement between one State and another."[25] What about a simple sale of land? Or the transportation of goods purchased? Or a joint effort to combat the outbreak of some disease? Thus, instead of looking to the text, the Justice decided that it would be better to look to the "object of the constitutional provision."[26] "[I]t is evident," he concluded, "that the prohibition is directed to the formation of any combination tending to the increase of political power in the States, which may encroach upon or interfere with the just supremacy of the United States."[27] With a few short words, Justice Field thus changed the direction of Compact Clause jurisprudence. Rather than requiring congressional approval for any agreement between states, the Court would require approval only for certain political agreements. His dictum was converted into constitutional law in the 1978 case of *United States Steel Corp. v. Multistate Tax Commission*.[28]

The plaintiffs in *U.S. Steel* sought to overturn an interstate compact that established the Multistate Tax Commission. The agreement had been submitted to Congress, but never approved. "On its face," Justice Powell wrote for the Court, "the Multistate Tax Compact contains no provisions that would enhance the political power of the member States in a way that encroaches upon the supremacy of the United States."[29] He admitted that there may be "some incremental increase in the bargaining power of the member States quoad the corporations," but "the test is whether the Compact enhances state power quoad the National Government."[30] Emphasizing that the agreement did not "authorize the member States to exercise any powers they could not exercise in its absence," no sovereign power had been delegated to the Commission, and "each State is free to withdraw at any time,"[31] Justice Powell found that congressional approval was not required.

Importantly, the Court briefly turned to an analysis of the impact of the compact on non-participating states—a matter that had received bare mention in *Virginia v. Tennessee*.[32] Powell deemed any "[r]isks of unfairness and double taxation" to be "independent of the Compact," at least in this case.[33] He left open the possibility that a compact implicating the "federal structure" could be problematic, but in the case of the Commission, he concluded, "it is not explained how any economic pressure that does exist is an affront to the sovereignty of nonmember States."[34]

In the wake of *Virginia v. Tennessee* and *U.S. Steel*, how would the Court assess the impact of NPV on the federal government and non-participating states? On the one hand, the Court has greatly weakened its Compact Clause jurisprudence.[35] Despite paying lip service to the importance of protecting federal and state sovereignty, it has never struck down a compact, as NPV proponents are quick to note.[36] Indeed, constitutional scholar Michael Greve once wrote of the "emasculation of the Compact Clause,"[37] noting that "[a]fter *U.S. Steel*, one can hardly imagine a state compact that would run afoul of the Compact Clause without first, or at least also, running afoul of other, independent constitutional obstacles."[38]

Yet reasonable arguments can be made that the compact *does* run afoul of other constitutional obstacles, as will be discussed below. (Indeed, these and other obstacles may be serious enough that, even if the compact is submitted, Congress arguably can't consent to it.) Moreover, even relying solely on the standards laid out in *U.S. Steel*, the impact of NPV on the federal and state governments is simply too great to be ignored.

The federal government has at least one important interest at stake.[39] As Professor Judith Best has noted, the federal government has a vested interest in protecting its constitutional amendment process.[40] If the NPV compact goes into effect, its proponents will have effectively changed the presidential election procedure described in the Constitution, without the bother of obtaining a constitutional amendment. Indeed, NPV proponents cite the relative ease of enacting the compact as a selling point. The compact could be implemented with the consent of as few as eleven states, whereas an amendment requires the ratification of thirty-eight states. But supermajority requirements for certain actions provide important protections for Americans' freedom, and it is the prerogative of the federal government to protect the Constitution's amendment process.

Non-compacting states have equally important interests. First, NPV deprives these states of their opportunity, under the Constitution's amendment process, to participate in any decision made about changing the nation's presidential election system. They are also deprived of the protections provided by the supermajority requirements of Article V. Second, the compact grants new authority for some states to control other states in certain situations: Specifically, if a member state changes its mind about joining the compact, other member states may sometimes be able to force compliance, thus compromising that state legislature's broad authority to determine the manner of elector allocation. Finally, the voting power of states relative to other states is changed. NPV is the first to bemoan the fact that "every vote is not equal" in the presidential election and that the weight of a voters' ballot depends on the state in which he lives. In equalizing voting power, NPV is by definition increasing the political power of some states and decreasing the political power of other states.[41]

NPV contends that non-compacting states are not impacted and that every state is treated equally under its plan because all votes are counted and given equal weight—even those cast in non-participating states.[42] And, proponents add, the compacting states are merely doing something that they are entitled to do anyway.[43] The Court has held that "the State legislature's power to select the manner for appointing electors is plenary; it may, if it so chooses, select the electors itself."[44] If some states want to allocate their electors to the winner of the national popular vote, then why shouldn't they?

NPV's position leads to a serious, unanswered constitutional question: Is this power of state legislators *completely* unrestricted?[45] If it is, then Rhode Island could decide to allocate its electors to the winner of the Vermont election. In a more extreme move, New York could allocate its electors to the United Nations. Florida could decide that Fidel Castro always appoints its electors. Arguably, the Constitution presupposes that the electors belong to each individual state and the state may not delegate this responsibility outside of state borders.[46] Such an argument gives state legislatures great discretion in allocating their electors, but not completely unfettered discretion.

NPV's best counter-argument is that none of these scenarios ever occurred to the Founders, and they thus did not place sufficient restrictions on the legislature's discretion. Members of the founding generation were distrustful of other states and the national government, and they almost certainly could not conceive that future state legislators would so thoughtlessly betray their own states' interests. In this scenario, NPV is the opposite of what the Founders wanted, but failure of imagination prevented the Founders from explicitly prohibiting this particular manner of allocating electors.

But even if NPV has found a loophole and proves that states could take such action alone, Article I, Section 10 forbids them from doing so jointly unless they first submit their

compact to Congress. If ever a compact encroached on federal and state sovereignty, this is it.

NPV's Constitutional Issues

NPV relies on the "plenary" power of state legislatures to select the manner in which its state will appoint electors.[47] However, as discussed above, a reasonable argument can be made that this power, while sweeping, is not without limit. Justice Thomas acknowledged as much in *U.S. Term Limits, Inc. v. Thornton*. "States may establish qualifications for their delegates to the electoral college," he noted, "as long as those qualifications pass muster under other constitutional provisions."[48] His comment was made in dissent, but the other justices did not dispute him on this particular point.

Does NPV "pass muster" under Article V, which does not allow constitutional provisions to be altered without approval by "the Legislatures of three fourths of the several States, or by Conventions in three fourths thereof"?[49] NPV argues "yes." Its proposal does not technically alter the text of Article II and the Twelfth Amendment. Instead, it asks state legislatures to use the text in a unique way. As discussed above, the argument is not without merit, but it is at best a loophole—a scenario completely unanticipated (and thus not explicitly prohibited) by the Founders. Moreover, such an assessment of NPV seems a bit disingenuous. As Cato scholar John Samples has observed: "NPV offers a way to institute a means of electing the president that was rejected by the Framers of the Constitution. It does so while circumventing the Constitution's amendment procedures."[50] If NPV is enacted, a court will almost certainly be asked to decide if it unconstitutionally alters America's presidential election process without first obtaining approval from the requisite number of states.

In two notable cases, the Court struck down statutes that were said to upset the compromises struck and the delicate balances achieved during the Constitutional Convention. The 1998 case of *Clinton v. New York* invalidated the federal Line Item Veto Act.[51] Writing for the majority, Justice Stevens emphasized the "great debates and compromises that produced the Constitution itself,"[52] and he found that the Act could not stand because it disrupted "the 'finely wrought' procedure that the Framers designed."[53] NPV thumbs its nose at the Founders and the painstaking process that they went through to create a Union acceptable both to small and to large states. The delegates to the Constitutional Convention rejected direct national election of the President. They instead created a process that would allow majorities to rule, but that would also slightly inflate the voice of small states (both in the Electoral College vote and in the House contingent election). The Court could reasonably determine that NPV destroys these compromises and that it disrupts the "finely wrought" procedures found in the Constitution—not only in Article II and the Twelfth Amendment, but also in Article V.

The Court would find support for such a holding in *U.S. Term Limits*. That case held that the Qualifications Clauses of the Constitution prevented an individual state from attempting to impose term limits on its own senators and congressmen. Justice Stevens's majority opinion seemed wary of statutes that attempt to evade the Constitution's requirements. Stevens wrote that a state provision "with the avowed purpose and obvious effect of evading the requirements of the Qualifications Clauses . . . cannot stand. To argue otherwise is to suggest that the Framers spent significant time and energy in debating and crafting Clauses that could be easily evaded."[54] Allowing such action, he concluded:

> trivializes the basic principles of our democracy that underlie those Clauses. Petitioners' argument treats the Qualifications Clauses not as the embodiment of a grand principle, but rather as empty formalism. "It is inconceivable that guaranties embedded in the Constitution of the United States may thus be manipulated out of existence."[55]

Stevens's concerns echo the statements of Electoral College supporters who worry that NPV is simply an "end run" around the constitutional amendment process. The Founders spent months debating the appropriate presidential election process for the new American nation. Can a handful of states now "easily evade" the compromises and provisions that resulted from that debate?

Justice Kennedy's concurrence in *U.S. Term Limits* further buttresses an argument for declaring NPV unconstitutional on its face. "Federalism was our Nation's own discovery," Kennedy began.[56] "The Framers split the atom of sovereignty. It was the genius of their idea that our citizens would have two political capacities, one state and one federal, each protected from incursion by the other."[57] Federalists often speak of the importance of defending the states from incursions by the federal government, but Kennedy remarked upon the need to protect the federal government from "collateral interference by the States."[58] He concluded, "That the States may not invade the sphere of federal sovereignty is as incontestable, in my view, as the corollary proposition that the Federal Government must be held within the boundaries of its own power when it intrudes upon matters reserved to the States."[59] His comments may have important implications for the legitimacy of the NPV compact. The states can't unilaterally override the federal constitutional amendment process. A court could reasonably find that NPV does just that.

Electoral College supporters often refer to the NPV plan as an "end-run" around the constitutional amendment process. NPV proponents deny this characterization of their efforts, claiming that they are merely using old constitutional provisions in new and innovative ways. But their arguments fall flat. Their compact is more than a creative way to use the Electoral College. It turns the current presidential election system on its head. The Court may treat it as such. The Constitution was the product of much give and take among the delegates. It is dangerous to forget that it would never have been ratified, at least by the small states, but for these compromises.

The Definition of "Legislature"

Article II, Section 1 of the Constitution provides that "[e]ach State shall appoint, in such Manner as the Legislature thereof may direct, a Number of Electors . . . ."[60] The precise definition of "Legislature" could influence if and when NPV goes into effect because of its impact on two questions: First,

must the legislature itself approve the NPV plan or can it be adopted by citizen initiative? Second, if a governor vetoes the plan, is the veto legally binding? If "Legislature" refers specifically to the lawmaking body and not to a state's lawmaking process, then the answer to both of these questions is "no." Three state governors have already vetoed NPV, so litigation on this matter is already a possibility.

No Supreme Court case definitively addresses this Article II use of "Legislature," and legal scholars remain split on how it should be interpreted. From a purely textualist perspective, the provision should be read as a reference to the lawmaking body, not the lawmaking process. Article II distinguishes between the responsibility of the state (to "appoint") and the legislature (to "direct"). Why delineate separate responsibilities if the general state lawmaking process could regulate the entire process of appointing electors? Indeed, Justices Rehnquist, Scalia, and Thomas seem to have come down on this side of the issue in their *Bush v. Gore* concurrence. That case, of course, sprung from the controversial Florida recount during the 2000 presidential election. The Florida Supreme Court had ordered a recount that would ultimately violate the Florida legislature's expressed wish to ensure that Florida electors are appointed before the federal "safe harbor" provision. "If we are to respect the legislature's Article II powers," Rehnquist argued, "we must ensure that postelection state-court actions do not frustrate the legislative desire to attain the 'safe harbor.'"[61] In short, the judiciary cannot take action that trumps legislative decision-making when the legislature is exercising its Article II duties. "This inquiry does not imply a disrespect for state *courts* but rather a respect for the constitutionally prescribed role of state *legislatures*," Rehnquist wrote.[62] The opinion was not controlling, however, and four Justices strongly rejected Rehnquist's opinion. Two other Justices expressed no opinion on this aspect of Article II.[63]

While the cases are not directly on point, the Court has also addressed the definition of "Legislature" in the context of Article I, Section 4 and Article V. In these cases, it has come down on both sides of the issue.

Article I provides that the "Times, Places and Manner of holding Elections for Senators and Representatives, shall be prescribed in each State by the Legislature thereof."[64] Importantly, it immediately qualifies the delegation of power: "but the Congress may at any time by Law make or alter such Regulations, except as to the Places of chusing Senators."[65] The qualification of power has proven to be critical. In *Ohio ex rel. Davis v. Hildebrant*, the Court was asked to decide if the people, by referendum, could repeal a redistricting plan that had been approved by the Ohio state legislature. Congress had passed a law requiring that "redistricting should be made by a State 'in the manner provided by the laws thereof.'"[66] The Court found the repeal by referendum to be valid because the "referendum constituted a part of the state constitution and laws and was contained within the legislative power."[67] The Court reached a similar decision in *Smiley v. Holm*. Minnesota's governor had vetoed the legislature's redistricting plan, and the Court was asked to decide if gubernatorial approval was necessary. Yes, the Court found, because "the function contemplated by Article I, section 4, is that of making laws."[68] Such a conclusion, the Court found, is

> confirmed by the second clause of Article I, section 4, which provides that "the Congress may at any time by law make or alter such regulations." . . . Prescribing regulations to govern the conduct of the citizen, under the first clause, and making and altering such rules by law, under the second clause, involve action of the same inherent character.[69]

Thus, the Court concluded, redistricting must comply with the normal lawmaking process in a state.

The decision in *Smiley* sharply contrasted with the Court's decision in *Hawke v. Smith*.[70] In the latter case, the Court considered the meaning of the word "Legislature" in the context of Article V, dealing with constitutional amendments. Petitioners sought to prevent a referendum vote on the proposed Eighteenth Amendment to the Constitution, which had already been approved by the state's legislature. The Court found that the legislature is not acting in its lawmaking capacity when it approves an amendment. To the contrary, "ratification by a State of a constitutional amendment is not an act of legislation within the proper sense of the word. It is but the expression of the assent of the State to a proposed amendment."[71] Indeed, the state ratification process, the Court noted, is parallel to the congressional approval process of an amendment, which does not require action by the President.

Despite the language in *Bush* and *Hawke*, NPV makes some reasonable arguments for accepting the broader definition of "Legislature," as found in the Article I, Section 4 line of cases. *Every Vote Equal* notes that two states had gubernatorial vetoes at the time the Constitution was adopted. During early presidential elections, both states considered the elector appointment issue just as they would have any other piece of legislation, including submitting their bills for gubernatorial action.[72] Such action indicates that these two state legislatures understood the word "Legislature" to mean "lawmaking process." *Every Vote Equal* also reasonably notes a statement made in *U.S. Term Limits*. In the majority opinion, Justice Stevens off-handedly remarked that the Article I legislative duty "parallels the duty under Article II."[73] However, Stevens was not discussing the definition of legislature. Instead, he was discussing which powers have been delegated to the states and which powers have been reserved by them.[74]

It would be ironic if NPV's point ends up carrying the day, requiring that the Article II use of "Legislature" be defined as "lawmaking process." NPV's objective in making such arguments was to ensure that its plan could be enacted through initiative. But winning that argument would also necessitate acceptance of the gubernatorial vetoes in California, Rhode Island, and Vermont. NPV would lose sixty-two votes that could otherwise have been used to help implement its interstate compact.

Closing Thoughts

This article has addressed several problems that will inevitably be the subject of litigation if a significant number of states approve the NPV compact. Any one of these questions requires serious thought and discussion (to say nothing of the lengthy litigation that would result). But this list is by no means exhaustive. Creative lawyers are likely to come up with even

more potential questions.[75] Matters could also get interesting if one state were to try and defend itself against the NPV compact, as discussed above.

The Article V constitutional amendment process exists for important reasons. American liberty is protected when that process is respected. The NPV debate, which is occurring largely behind the scenes and in only a handful of states, is not healthy for the country. Those who wish to eliminate the Electoral College would serve their country better if they instead introduced a constitutional amendment to that effect. The national discussion and education that would ensue would be healthy for this country.

Endnotes

1 *See* http://www.nationalpopularvote.com.

2 Jamin B. Raskin, *Neither the Red States nor the Blue States but the United States: The National Popular Vote and American Political Democracy*, 7 Election L.J. 188, 189 (2008).

3 U.S. Const. art. II, § 1, cl. 2.

4 Shortly before this piece went to press, the Massachusetts House approved NPV, sending it to the state Senate for consideration. The New York State Senate also passed the bill. A few other states could feasibly take action on the bill before publication of this article, although most state legislatures are unlikely to consider the bill before 2011.

5 John R. Koza et al., Every Vote Equal: A State-Based Plan for Electing the President by National Popular Vote (2d ed. 2008).

6 *See* Tara Ross, Enlightened Democracy: The Case for the Electoral College (2004).

7 Videotape: The Electoral College Experts Debate and Audience Dialogue (Part 4) (MIT Conference, To keep or not to keep the Electoral College: New Approaches to Electoral Reform 2008), *available at* http://mitworld.mit.edu/video/631 [hereinafter MIT Conference].

8 *See, e.g.*, Bradley A. Smith, *Vanity of Vanities: National Popular Vote and the Electoral College*, 7 Election L.J. 196, 207-08 (2008). NPV's member states could presumably seek agreement on one statutory scheme for conducting recounts, but they could not force non-participating states to adopt such laws.

9 Koza et al., *supra* note 5, at 248.

10 *Id.*

11 *Id.*

12 *See, e.g.*, Smith, *supra* note 8, at 207.

13 Koza et al., *supra* note 5, at 364.

14 *Id.* at 361.

15 *See* Ross, *supra* note 6, at 96-100; *see also* Judith A. Best, The Choice of the People? Debating the Electoral College 55-58 (1996); Robert M. Hardaway, The Electoral College and the Constitution: The Case for Preserving Federalism 20-21 (1994).

16 *See* Ross, *supra* note 6, at 102-06.

17 Smith, *supra* note 8, at 207.

18 Koza et al., *supra* note 5, at 248 (emphasis added).

19 *Id.*

20 *See* Alexander S. Belenky, *Reasons to Kill Popular-Vote Plan*, Providence J.-Bull., April 11, 2009, at 4.

21 Koza et al., *supra* note 5, at 249.

22 *See, e.g.*, David Gringer, *Why the National Popular Vote Plan is the Wrong Way to Abolish the Electoral College*, 108 Colum. L. Rev. 182, 224, 230 (2008).

23 U.S. Const. art. I, § 10, cls. 1 & 3.

24 148 U.S. 503 (1893).

25 *Id.* at 518 (emphasis added).

26 *Id.* at 519; *see also* Michael S. Greve, *Compacts, Cartels, and Congressional Consent*, 68 Mo. L. Rev. 285, 300 (2003).

27 148 U.S. at 519.

28 434 U.S. 452 (1978).

29 *Id.* at 472.

30 *Id.* at 472-73.

31 *Id.* at 473.

32 *See* Derek T. Muller, *The Compact Clause and the National Popular Vote Interstate Compact*, 6 Election L.J. 372, 385 (2007) (arguing that "[e]very Compact Clause case, from *Virginia v. Tennessee* to the modern cases, considers not simply the federal sovereignty interest, but also the interests of non-compacting sister states").

33 434 U.S. at 478.

34 *Id.*

35 If the Court were to completely reevaluate its Compact Clause jurisprudence, it could feasibly find the compact to be a treaty, completely forbidden by Article I, Section 10 of the Constitution. Such a scenario seems unlikely, though. Greve has written a persuasive article arguing that, even in that case, Congress is the appropriate body to determine the difference between a treaty and a compact. Greve, *supra* note 26, at 308-14.

36 Koza et al., *supra* note 5, at 229.

37 Greve, *supra* note 26, at 288.

38 *Id.* at 308.

39 The federal government might also argue that NPV affects the balance of power between federal and state governments because the House's role in presidential elections will be effectively removed. Adam Schleifer, *Interstate Agreement for Electoral Reform*, 40 Akron L. Rev. 717, 739-40 (2007). Currently, the House of Representatives selects the president if no candidate obtains a majority of electoral votes. U.S. Const. amend. XII. NPV eliminates this possibility.

40 MIT conference, *supra* note 7.

41 *See* John Samples, Cato Institute, A Critique of the National Popular Vote Plan for Electing the President (2008).

42 Koza et al., *supra* note 5, at 339.

43 *Id.* at 372-74.

44 Bush v. Gore, 531 U.S. 98, 104 (2000).

45 Thanks to a conversation with Michael Greve in which he pointed out some of the scenarios in this paragraph, this author has come to the conclusion that she has perhaps been a bit too glib about this matter in the past. She has, for instance, been known to joke that states have "plenary" power and can appoint Mickey Mouse as an elector, if they so choose. They probably could appoint Mickey Mouse—or at least the individual who puts on the mouse suit—but upon considering the ways in which such a principle could be abused, it was perhaps better not to make such loose statements, even in jest.

46 *Cf.* Douglas Laycock, *Equal Citizens of Equal and Territorial States: The Constitutional Foundations of Choice of Law*, 92 Colum. L. Rev. 249, 251 (1992) (arguing that the "fundamental allocation of authority among states is territorial" although the principle "is largely implicit, so obvious that the Founders neglected to state it").

47 *Bush*, 531 U.S. at 104.

48 U.S. Term Limits, Inc. v. Thornton, 514 U.S. 779, 861 (1995) (Thomas, J., dissenting).

49 U.S. Const. art. V.

50 Samples, *supra* note 40, at 13-14.

51 Clinton v. New York, 524 U.S. 417 (1998).

52 *Id.* at 439.

53 *Id.* at 440.

54 U.S. Term Limits, Inc. v. Thornton, 514 U.S. 779, 831 (1995).

55 *Id.* (citation omitted).

56 *Id.* at 838 (Kennedy, J., concurring).

57 *Id.*

58 *Id.* at 841.

59 *Id.*

60 U.S. Const. art. II, § 1, cl. 2.

61 Bush v. Gore, 531 U.S. 98, 113 (2000) (Rehnquist, CJ., concurring).

62 *Id.* at 115.

63 *See also* Richard L. Hasen, *When "Legislature" May Mean More than "Legislature": Initiated Electoral College Reform and the Ghost of* Bush v. Gore, 35 Hastings Const. L.Q. 599, 610-16 (2008).

64 U.S. Const. art. I, § 4, cl.1.

65 *Id.*

66 Ohio *ex rel.* Davis v. Hildebrant, 241 U.S. 565, 568 (1916).

67 *Id.*

68 Smiley v. Holm, 285 U.S. 355, 366 (1932).

69 *Id.* at 366-67.

70 Hawke v. Smith, 253 U.S. 221 (1920).

71 *Id.* at 229.

72 Koza et al., *supra* note 5, at 317-20.

73 U.S. Term Limits, Inc. v. Thornton, 514 U.S. 779, 805 (1995).

74 *Id.* at 804-05.

75 For instance, does NPV violate Section 2 of the Voting Rights Act? Is preclearance required under Section 5? *See generally* Gringer, *supra* note 22. Another author has made the tougher argument that NPV violates the Guarantee Clause. *See* Kristin Feeley, *Guaranteeing a Federally Elected President*, 103 Nw. U. L. Rev. 1427 (2009).

Financial Services & E-Commerce

The "Volcker Rule": Barring Banking Organizations from Proprietary Trading, Fund Investment, and Sponsorship

*By Julius L. Loeser**

The "Volcker Rule" is a new federal statute proposed by the President at the instance of former Federal Reserve Chairman Paul Volcker that would ban proprietary trading, i.e., trading for a bank's own account, as opposed to that of a customer, in a bank's trading book. The trading book is an accounting concept and distinguishes the way an asset is held based on the holder's intent to trade the asset as opposed to holding it to maturity, the carrying value of the former being marked to market daily. The Volcker Rule exempts both market-making and hedging activity from the prohibition and would also exclude securities that banks have long been permitted to underwrite and deal in, such as bonds issued by the U.S. government and its agencies and state and local bonds, as well as Government National Mortgage Associations ("GNMAs"), Federal National Mortgage Associations ("FNMAs"), and Federal Home Loan Mortgage Corporations ("FHLMCs"). It appears that trading foreign exchange and interest rate swaps, traditional devices used by banks to mitigate the risk of changes in currency values and interest rates, are covered and thus would be prohibited. Underwriting is expressly permitted, as is securitization of loans.

The Rule would also generally prohibit a banking organization's investing in or sponsoring hedge funds and private equity funds, but not other types of mutual funds. Bank-holding companies have been a major source of funds invested in private equity funds. The final bill does permit a banking entity to invest in up to three percent (3%) of the ownership interests in a fund it organizes and offers, capping the aggregate amount of such investments at three percent (3%) of the banking entity's Tier 1 capital.

In many ways, this appears to be the functional equivalent of reinstating the Glass-Steagall Act, which was repealed in large part by the Gramm-Leach-Bliley Act in 1999. The Glass-Steagall Act prohibited commercial banks and their affiliates from underwriting and dealing in corporate securities. Andrew Haldane, the Bank of England's executive director for financial stability, recently reminisced about the simplicity of the Glass-Steagall Act's separation of commercial and investment banking over its sixty-six years as contrasted with the enormous complexity of international capital regulations adopted after its repeal in order to require the largest banking organizations to maintain amounts of capital related to the risk of the assets held by such firms.[1]

Ironically, proprietary traders do not have large bank affiliates[2] and might be expected to divest their banks ("debank") if the Volcker Rule became law.[3] Conversely, most banking organizations are not significant proprietary traders; except for Goldman Sachs and Citicorp,[4] proprietary trading has represented less than one percent of the revenues of most banks.

I. Background

On June 17, 2009, the Administration issued an eighty-nine-page "White Paper," "Financial Regulatory Reform—A New Foundation: Rebuilding Financial Supervision and Regulation," ("June White Paper") containing a comprehensive set of proposals for financial regulatory reform that included creating a new Financial Services Oversight Council to identify emerging risks and advise the Federal Reserve Board on the identification of firms whose failure could pose a threat to financial stability; implementing heightened consolidated supervision and regulation of all large, interconnected firms; strengthening capital and other prudential standards for all banks and bank holding companies (including executive compensation practice standards); creating a new National Bank Supervisor; providing for the conversion of depository institutions that have been historically dedicated to financing home ownership to commercial bank status; requiring advisers to hedge funds and other private pools of capital above a "modest threshold" to register with the Securities and Exchange Commission under the Investment Advisers Act; establishing an Office of National Insurance; requiring promulgation of regulations requiring originators or sponsors of credit securitizations to retain an economic interest in a material portion of the credit risk; regulating all over-the-counter derivatives markets, including credit default swap markets; providing oversight of payment, clearing, and settlement systems; creating a new consumer financial protection agency and eliminating National Bank Act preemption of state consumer finance protection laws; establishing a special resolution framework for failing systemically important financial firms; restricting the ability of the Federal Reserve to lend to nonbank firms in unusual and exigent circumstances; and tightening oversight of credit rating agencies.

The June White Paper served as the basis of H.R. 4173, a bill introduced in the House of Representatives by House Financial Services Committee Chairman Barney Frank in August 2009. The paper also served as the basis of a discussion draft bill offered by the Senate Banking, Housing, and Urban Affairs Committee ("Senate Banking Committee") Chairman Christopher Dodd. The draft bill was not introduced because it initially received a hostile reception at a meeting of the Senate Banking Committee.

The June White Paper did not mention bank proprietary trading[5] or bank investment or sponsorship of hedge funds or private equity funds other than to suggest in the discussion of strengthening prudential safeguards that bank regulators

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"should tighten the supervision and regulation of potential conflicts of interest generated by the affiliation of banks and other firms, such as proprietary trading units and hedge funds."[6] After many hearings, mark-ups, and much work, the House of Representatives passed H.R. 4173, codifying much of the June White Paper, on December 11, 2009. It authorized the bank regulators to bar proprietary trading by banking organizations but did not prohibit such trading, and it was silent as to bank investment and sponsorship[7] of hedge funds.

On January 21, 2010, the President, with former Federal Reserve Chairman Paul Volcker standing by his side,[8] announced that the two agreed on the notion that banks should be barred from proprietary trading and from investing and sponsoring hedge funds and private equity funds (the "Volcker Rule"); details were to follow.

The Administration had not discussed this idea with foreign regulators, despite its well-known aversion to unilateral action in the foreign policy arena, and foreign banking regulators were not supportive of the concept. The head of the International Monetary Fund, Dominique Strauss-Kahn, was quoted, shortly after the President's announcement of the Volcker Rule, as saying that "the question of coordinating financial reform is key and we are not going in that direction."[9] The Deputy Director-General of the European Commission's Internal Market and Services Division, David Wright, expressed surprise in late January that the U.S. had taken this position without consulting leaders in Europe.[10] Ironically, the June White Paper expressly represented that the United States is playing a strong leadership role in efforts to coordinate international financial policy through the G-20, the Financial Stability Board, and the Basel Committee on Banking Supervision and recommended raising international regulatory standards and improving international cooperation. This is very important in the financial area, as there appears to be a growing consensus that unilateral action by any one country may well drive financial firms to other countries with friendlier regulatory environments, and, thus, a premium should be placed on international cooperation in the area of financial regulatory reform.

On February 4, 2010, the Senate Banking Committee held a hearing on the Volcker Rule at which a handful of witnesses, including former Federal Reserve Bank of New York President E. Gerald Corrigan (now a Managing Director of Goldman, Sachs & Co.), former Chief Executive Officer of Citibank John Reed, and Chief Risk Officer of JP Morgan Chase & Co. Barry Zubrow, testified.

On February 22, 2010, a letter to the editor of *The Wall Street Journal* appeared supporting the Volcker Rule; it was notable because it was signed by five former Secretaries of the Treasury from both Republican and Democratic Administrations: W. Michael Blumenthal, Nicholas Brady, Paul O'Neill, George Schultz, and John Snow. It was also notable that the letter had not been signed by former Goldman Sachs executives who had served as Secretaries of the Treasury, Robert Rubin and Henry Paulson. The basis of the concern was simply stated: "Banks benefiting from public support . . . should not engage in essentially speculative activities unrelated to essential banking services." Hedge funds, private equity funds, and firms trading for speculative gains should, like other private businesses, be free to fail without explicit or implicit taxpayer support.

On March 3, 2010, the Treasury Department released five pages of legislative language that would add new Sections 13 and 13a to the Bank Holding Company Act to implement these prohibitions as well as another prohibition proposed by the President and Chairman Volcker in January against acquisitions by financial companies that would result in the acquiror holding more than ten percent of the aggregate consolidated liabilities of all financial firms. The Volcker Rule language would apply the prohibitions to insured depository institutions and to companies that control them or that are treated as bank holding companies,[11] but would except trading in obligations of the U.S., its agencies, GNMAs, FNMAs, FHLMCs, and obligations of state and local governments. The language would also prohibit such firms sponsoring or investing in hedge funds or private equity funds, but would except investments in small business investment companies and investments designed primarily to promote public welfare. In addition, the language would prohibit a bank's or its parent's loans to, investments in, purchases of assets from, acceptance of securities of (as collateral), and issuances of letters of credit on behalf of, any hedge fund or private equity fund if the bank or parent serves directly or indirectly as investment manager or adviser of such fund. Finally, the language would prohibit any insured depository institution or holding company that serves as investment manager or adviser to a hedge fund or private equity fund from providing custody securities lending or other prime brokerage services to the fund.

A week later, on March 10, 2010, Senators Jeffrey Merkley and Carl Levin introduced the "Protect Our Recovery through Oversight of Proprietary Trading Act" (the "PROP Trading Act"), S. 3098. Its prohibitions and exceptions track those set forth in the Treasury language, but the exceptions would only apply where it would not result in a material conflict of interest or in exposure to high risk assets or trading strategies as to be defined by the Federal Reserve Board and FDIC or pose a threat to safety and soundness or to the financial stability of the U.S. The bill would also add a new Section 27A to the Securities Act of 1933[12] that would prohibit an underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security from engaging in any transaction that would either give rise to a material conflict of interest "with respect to any investor in a transaction arising out of such activity" or undermine the value, risk, or performance of the asset-backed security.

Senator Christopher Dodd, the Chairman of the Senate Banking Committee, introduced his own comprehensive financial regulatory reform bill, the Restoring American Financial Stability Act of 2010, on March 15. Section 619 of the bill was a modified version of the Volcker Rule. It clarified that the prohibitions would not only apply to banks and their parents, but also to subsidiaries of either, which was not clear in the Treasury or Merkley language. However, rather than being a self-executing prohibition, the bill provided that, subject to the recommendations and modifications of

a newly-established council of regulators created in order to reduce systemic risk, the bank regulatory agencies, through a rulemaking, are jointly to prohibit proprietary trading by banking organizations and also prohibit their sponsoring and investing in hedge funds. In addition, the Federal Reserve, subject to the council's recommendations and modifications, would be required to adopt rules imposing additional capital requirements and specifying quantitative limits for systemically important nonbank firms that engage in proprietary trading or sponsor and invest in hedge funds. The council would undertake a six-month study of whether the prohibition would promote safety and soundness, enhance financial stability, limit the "inappropriate transfer of Federal subsidies," reduce inappropriate conflicts of interest, raise the costs of credit, and limit activities that might reasonably be expected to create undue risk. The regulators were to adopt final regulations within nine months after completion of this study, effective in two years, subject to three one-year additional extensions.

On May 20, 2010, the Dodd bill passed the Senate. After amending Section 619 to permit the aforesaid three percent (3%) investments, the House-Senate Conference Committee reported the bill out, and the President signed it on July 21, 2010.

II. Rationale

When the President proposed the Volcker Rule, he alluded to existing rules "that allowed firms to act contrary to the interests of customers;[13] to conceal their exposure to debt through complex financial dealings;[14] to benefit from taxpayer-insured deposits while making speculative investments; and to take on risks so vast that they posed threats to the entire system." He explained government benefits that banks receive (deposit insurance, a safety net (presumably the Federal Reserve discount window) which reduces bank capital costs) and concluded it was "not appropriate" to "use that cheap money to trade for profit," especially when this trading conflicts with the interests of a bank's customers. He then suggested that this kind of trading can create enormous and costly risks. Thus, the proposed ban would appear to have three bases: (1) inappropriateness of using government support to trade, (2) conflicts between trading and loyalty to customers, and (3) risk.

III. Analysis

The Volcker Rule may be analyzed by breaking it first down into its two components: proprietary trading and activities related to pools of capital, i.e., hedge funds and private equity funds.

However, first, it is important to note that, while there may have arguably been many causes of the financial crisis, neither proprietary trading nor investing in or sponsoring funds has conventionally been considered to be among them. Chairman Volcker himself has acknowledged this,[15] though recently he has suggested it might cause the next financial crisis.[16] Failures of Washington Mutual and IndyMac and problems at Wachovia and Countrywide were attributable to defaulting subprime mortgage loans, not proprietary trading or investing in, or sponsorship of, funds. Similarly, the failure of Lehman Brothers and the problems at Bear Stearns and Merrill Lynch are usually attributed to excessive real estate credit risk, not to trading, investing in, nor sponsoring funds. Of course, the Volcker Rule would only apply to banking organizations; however, some of the biggest problems in the financial crisis occurred at nonbank firms, such as FNMA, FHLMC, Bear Stearns, and Lehman Brothers. Indeed, rather than causing the financial crisis, it has been suggested that proprietary trading, fund sponsorship, and investment activities diversified the revenues of banking organizations and thus stabilized banking organizations.

It also appears that regulators currently have ample authority to control any risks they see in these areas. Capital regulation, currently well within the power of all of the bank regulators, is an obvious existing tool to control any risks regulators see with proprietary trading or investment in, or sponsorship of, funds. (Indeed, under current rules, capital requirements increase as investments increase.) Obviously these activities are also subject to examination authority that bank regulators currently have.

A. Proprietary Trading

Ironically, those banking organizations that have at all significant proprietary trading revenues have very small bank deposit bases, and conversely, most banking organizations with significant deposit bases have insignificant trading revenues. Thus, deposit liabilities represent slightly more than five percent of Goldman Sachs' total liabilities, and Morgan Stanley's bank represents less than nine percent of its total liabilities. Theoretically, therefore, both could debank in order to avoid a proprietary trading ban.[17] Proprietary trading at traditional large banks, such as Wells Fargo and Bank of America, accounts for less than one percent of total revenue. Goldman Sachs, admittedly not disinterested, estimates that cumulative credit losses reported by U.S. banks during the crisis approximated $1.67 trillion, only two percent of which was accounted for by trading and derivatives activity.[18] Thus, it is difficult to see how the Volcker Rule as to proprietary trading would reduce risk significantly.

Initial criticism of the non-detailed original Volcker Rule's ban on proprietary trading by banking organizations was focused on how difficult it would be to define "proprietary trading" without impinging on admittedly legitimate trading for customers, especially market-making and hedging. However, Treasury's language released March 3 simply defined proprietary trading to exclude transactions for customers, market-making, and hedging, and that has been reflected in both bills that have been introduced.

One basis that the President cited for the Volcker Rule was the need to restrain conflicts of interest. The Merkley-Levin bill implementing the Volcker Rule would go so far as to prohibit an underwriter, placement agent, initial purchaser, or sponsor of an asset-backed security from engaging in any transaction that would give rise to a material conflict of interest with respect to any investor in that transaction. Former Reserve Bank President Corrigan, testifying at the Senate Banking Committee hearing on the Volcker Rule, rightly noted that there is nothing new about potential conflicts in banking and

finance. However, banking firms manage such conflicts with so-called "Chinese Walls," policies and procedures to maintain separation of conflicted business units and to block the flow of information between them, as well as embedding independent lawyers and compliance professionals in revenue-producing business units.

Chairman Volcker, though, has testified that these activities "present virtually insolvable conflicts of interest with customer relationships, conflicts that simply cannot be escaped by an elaboration of so-called Chinese walls between different divisions of an institution."[19] He specifically cited the conflict between a bank's investment management activities and trading for the bank's own account. He urged that an institution should not be able to profit from knowledge of a customer's trades through proprietary trading activity.

Chairman Volcker's concern about conflicts of interest reminds one of the conflicts of interest cited as the reasons for enactment of the Glass-Steagall Act in 1933. The United States Supreme Court reviewed those conflicts in *Investment Company Institute v. Camp*,[20] which featured what a former colleague of mine in the Legal Division of the Federal Reserve Board used to call the "chamber of horrors argument." Besides giving banks an incentive to give interested advice to clients, permitting banking organizations to trade securities for their own account, according to the Court, could jeopardize crucial public confidence in banks if such trading caused losses and even could bias credit decisions as banks might more willingly lend to portfolio companies or persons willing to invest in portfolio companies. Unfortunately—or fortunately, depending on one's perspectives—Congress reconsidered in 1999 and repealed much of the Glass-Steagall Act, enacting the financial modernization in the Gramm-Leach-Bliley Act. Had it not done so, JP Morgan Chase would not have been able to come to the rescue of Bear Stearns, and Bank of America would not have been able to come to the rescue of Merrill Lynch. Nor would Goldman Sachs and Morgan Stanley have been able to save themselves by becoming bank holding companies.

B. Hedge Funds and Private Equity Funds

The Volcker Rule would also prohibit banking organizations from sponsoring or investing in hedge funds and private equity funds.

Deputy Treasury Secretary Neal Wolin, apparently alluding to Bear Stearns' pledge of $3.2 billion to bail out Bear Stearns High-Grade Structured Credit Fund and Bear Stearns High-Grade Structured Enhanced Leverage Fund, has noted that major firms saw their hedge funds suffer large losses in the financial crisis and bailed out their troubled hedge funds, depleting firm capital at precisely the moment that capital was most needed.[21]

Under new Financial Accounting Standards 166 and 167, however, the securitized loans held by any such bank-sponsored hedge fund now remain on the books of the bank if such loans were originated by the bank, and the bank would be required, therefore, to maintain capital against those assets. That arguably is the functional equivalent of setting aside funds for a bailout.

Former New York Federal Reserve Bank President Corrigan suggested, as have others, that financial risks associated with banking organization ownership or sponsorship of hedge funds and private equity funds certainly could be dealt with by means short of outright prohibition. He suggested that bank owners and sponsors of such funds perhaps might be subjected to a prohibition against further investments in such funds unless they first apply for and receive regulatory approval.

Hedge funds and private equity funds are hardly risky gambling operations. To the contrary, they provide equity capital and debt financing to small and medium-sized businesses, which are job-creating enterprises. Limiting investment in, and sponsorship of, such funds would seem to discourage, not encourage, economic growth. Banks are important investors and general partners in private equity funds, and prohibiting those investments would reduce the amount of capital available to such funds and thus impede the flow of capital from such banking organizations to small and medium-sized businesses.

Yet, like proprietary trading, this activity does not represent a significant portion of bank assets, as it represents less than one percent of total assets of traditional banks like Bank of America, Wells Fargo, JP Morgan, and Citigroup and less than two percent of the total assets of non-traditional banking organizations such as Goldman Sachs and Morgan Stanley.

As Mr. Corrigan suggested, the involvement of banking organizations in such funds can improve business practices in the fund industry.

IV. Conclusion

It is not clear that the Volcker Rule would achieve its goals, as most banking organizations are not significantly engaged in proprietary trading or sponsoring and investing in funds. On the other hand, enactment of the Volcker Rule could hurt healthy diversification of income streams of banking organizations and reduce capital flows to small and medium-sized businesses, neither of which is a positive pro-safety and soundness, financial growth-oriented economic outcome.

Though the Volcker Rule may have these problems one cannot lightly dismiss it in light of the respect to which its chief proponent, Chairman Volcker, is entitled, as well as the respect due so many of its other proponents. Whether its adoption was wise public policy, all can agree, needs to be carefully considered and studied. It may have been exceedingly unwise to enact financial reform affecting the very lifeblood of our economy without very carefully and thoroughly considering all of the consequences.

Endnotes

1 Larry Elliott, *Forced Bank Break-up Makes Sense, Says Financial Stability Chief*, Guardian, March 30, 2010.

2 Morgan Stanley's banking liabilities represented 8.7% of its total liabilities at year-end 2009, and Goldman's represented 5.19%.

3 The Dodd bill contains a so-called "Hotel California" provision to the effect that, once a firm becomes a bank holding company, it "can never leave." Section 117 of the bill provides that any bank holding company that had total consolidated assets of $50 billion or more January 1, 2010 and received funds under the U.S. Treasury's Capital Purchase Program under the Troubled Asset Relief Program (TARP) shall be treated as a systemically significant firm subject to Federal Reserve Board supervision and special bank-like prudential standards (subject to an appeal to the new Financial Stability Oversight Council) even if the firm ceases to be a bank holding company. The reference to "Hotel California" is based on the lyrics of the popular 1976 song "Hotel California" recorded by the musical group "The Eagles," which contains the line, "You can check out any time you like, but you can never leave." Some commentators believe that Section 117 is intended to prevent Goldman Sachs and Morgan Stanley from debanking if the Volcker Rule goes into effect

4 Proprietary trading represented approximately ten percent of Goldman's revenues and five percent of Citi's.

5 The Volcker Rule defines "proprietary trading" as:

> engaging as a principal for the trading account of the banking entity or nonbank financial company supervised by the Board in any transaction to purchase or sell, or otherwise acquire or dispose of, any security, any derivative, any contract of sale of a commodity for future delivery, any option on any such security, derivative, or contract, or any other security or financial instrument that [the regulators] may . . . determine.

6 U.S. Department of the Treasury, Financial Regulatory Reform: A New Foundation: Rebuilding Financial Supervision and Regulation 32 (2009).

7 The Volcker Rule defines "sponsorship" to mean:

> (A) serving as a general partner, managing member, or trustee of a fund;
>
> (B) in any manner selecting or controlling (or having employees, officers, or directors, or agents who constitute) a majority of the directors, trustees, or management of a fund; or
>
> (C) sharing with a fund, for corporate, marketing, promotional, or other purposes, the same name or a variation of the same name.

8 Former SEC Chairman William Donaldson was also present at the announcement.

9 Simon Carswell, *IMF Head Calls for Financial Reform*, Irish Times, Jan. 30, 2010.

10 Joel Clark, *EC Says Obama Prop Trading Plan Would Be "Difficult" to Implement*, Risk Mag., Feb. 1, 2010.

11 Section 8 of the International Banking Act of 1978 (12 U.S.C. 3106) provides that any foreign bank that maintains a branch or agency in a state and any parent of such a bank are subject to the provisions of the Bank Holding Company Act.

12 15 U.S.C. 77a et seq.

13 Subsequently there have been media reports of at least one major securities firm promoting the sale of asset-backed securities to customers and then selling such securities short.

14 Subsequently an examiner in the Lehman bankruptcy has reported that Lehman concealed its exposure to debt using "window-dressing" repurchase agreement transactions known as "Repo 105," a reference to true sale accounting treatment given because "sold" assets were valued at 105% of the sales price received.

15 Reuters, *Volcker: Proprietary Trading Was Not Central to Crisis*, CNBC.com, March 30, 2010, http://www.cnbc.com/id/36101228/Volcker_Proprietary_Trading_Was_Not_Central_to_Crisis; Paul Volcker, Chairman of the Federal Reserve, Speech to the New York Historical Society (April 6, 2010).

16 Speech by Paul Volcker, *supra* note 15.

17 But see note 3 regarding the "Hotel California" provision in the Dodd bill.

18 Goldman Investment Research, United States: Banks 6 (2009).

19 *Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing, and Urban Affairs*, 111th Cong. (Feb. 2, 2010) (statement of Paul A. Volcker, Chairman, President's Economic Recovery Advisory Board).

20 401 U.S. 617 (1971).

21 *Prohibiting Certain High-Risk Investment Activities by Banks and Bank Holding Companies: Hearing Before the S. Comm. on Banking, Housing and Urban Affairs*, 111th Cong. (Feb. 2, 2010) (statement of Neal S. Wolin, Deputy Secretary, U.S. Dep't of Treasury).

Free Speech & Election Law

Recent Developments in Election Law

*By Kathryn Biber and John Hilton**

It is difficult to overstate the extent to which political speech in America today is shaped—in volume, timing, and style—by federal election laws and Federal Election Commission regulations. When political actors and issue groups seek to disseminate a message, their first call is often to a lawyer: "How should I organize? Who may contribute to my cause? What am I, and other people and groups that support me, allowed to say?" In recent months, several groundbreaking decisions have shifted dramatically the boundaries of permissible conduct, raising such questions to a fever pitch.

In *Citizens United v. FEC*, the Supreme Court overturned a ban on corporate and union independent expenditures (i.e., expenditures not coordinated with a campaign). In *EMILY's List v. FEC*, the U.S. Court of Appeals for the D.C. Circuit overturned FEC regulations prohibiting non-profit organizations from using "soft money" to fund certain election-related activities. In *SpeechNow.org v. FEC*, the D.C. Circuit overturned limits on individual contributions to organizations making independent expenditures. Finally, in *Republican National Committee v. FEC*, a three-judge panel of the U.S. District Court for the District of Columbia upheld restrictions on soft-money contributions to political parties.

These decisions will have a profound effect on politics in the near and long terms. We summarize them below, describe some developments in Congress, and then provide analysis by four experts in the field.

Case Summaries

Citizens United

Of these four cases, the Supreme Court's decision in *Citizens United v. FEC*[1] certainly caused the biggest splash among pundits, politicians, and scholars. *Citizens United* began as a case about a political documentary film whose makers sought to avoid campaign finance regulations, and eventually led to a confrontation between President Obama and the Supreme Court during the 2010 State of the Union address. To draw the President's ire, the Court overturned *Austin v. Michigan Chamber of Commerce*,[2] and held that the First Amendment protects the right of unions and all corporations (for-and-non-profit alike) to make independent expenditures expressly advocating the election or defeat of a candidate for public office.

Citizens United is a 501(c)(4) non-profit corporation. In addition to other activities, Citizens United has released documentary films on illegal immigration, the United Nations, and America's religious heritage. With the 2008 Democratic presidential primaries looming, Citizens United decided the time was ripe for a documentary about Hillary Clinton's life and career, in the style of Michael Moore's *Fahrenheit 9/11*.

Hillary: The Movie portrays Clinton in a decidedly negative light. Although the film does not use any so-called magic words advocating her "election or defeat, such as 'vote for,' 'elect,' 'support,' 'cast your ballot for,' '[Clinton for President],' 'vote against,' 'defeat,' [or] 'reject,'"[3] the Court held that *Hillary* "is equivalent to express advocacy. The movie, in essence, is a feature-length negative advertisement that urges viewers to vote against Senator Clinton for President."[4] The Court thus refused to dodge the main issue, i.e., whether *Hillary* was subject to federal campaign finance regulations at all.[5]

Historically, the Tillman Act of 1907 prohibited corporations from contributing directly to federal candidates.[6] In 1947, over President Truman's veto, Congress passed the Taft-Hartley Act, which "prohibit[ed] independent expenditures by corporations and labor unions," although the Court repeatedly avoided ruling on the constitutionality of this provision.[7] The Federal Election Campaign Act of 1971 ("FECA") later barred corporations and unions from "mak[ing] a contribution or expenditure in connection with" a federal election.[8] The Supreme Court, however, has cautioned that the independent expenditure prohibition is constitutional only to the extent that it prohibits express advocacy or its functional equivalent.[9]

In the Bipartisan Campaign Reform Act of 2002 ("BCRA"), Congress prohibited corporations and unions from using general treasury funds to make independent expenditures for "electioneering communications" mentioning a federal candidate.[10] BCRA defines an "electioneering communication" as "any broadcast, cable, or satellite communication" that "refers to a clearly identified candidate for Federal office" and is broadcast within thirty days of a primary election or sixty days of a general election.[11] Essentially, BCRA is based on the presumption that any political speech mentioning a federal candidate within this time period is the functional equivalent of express advocacy, and therefore can be regulated constitutionally by Congress.[12]

This was a problem for Citizens United, because, like any producer, Citizens United wanted to advertise *Hillary* on broadcast and cable television. To this end, Citizens United prepared two ten-second ads and one thirty-second ad. Naturally, Citizens United wanted to advertise *Hillary* when public interest was highest, i.e., during the Democratic primary season, which under BCRA was a felony punishable by five years imprisonment. Citizens United also proposed to release *Hillary* through video-on-demand, but the FEC responded that there is "no sound constitutional basis for exempting video-on-demand

....

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broadcasts from BCRA's restrictions on corporate financing of electioneering communications."[13]

In *Buckley v. Valeo* the Court struck down a limit on *individual* (not corporate) independent expenditures,[14] meaning expenditures that are not coordinated with a candidate. The *Buckley* Court held that in the absence of coordination there was no risk of quid pro quo corruption, and that only this kind of corruption or its appearance could justify the restrictions of FECA.[15] In *Austin*, however, the Court upheld a Michigan law prohibiting corporate independent expenditures to support or oppose candidates. The Court found the Michigan law was supported, not by a compelling interest in preventing the reality or appearance of quid pro quo corruption, but by "a different type of corruption in the political arena: the corrosive and distorting effects of immense aggregations of wealth that are accumulated with the help of the corporate form and that have little or no correlation to the public's support for the corporation's political ideas."[16]

Since it was decided, *Austin* has remained a jurisprudential outlier. The Court has not extended its concept of corruption to other cases, while continuing to treat the reality or appearance of quid pro quo corruption as the lodestar of campaign finance regulation. In the 2007 Term, the Court explicitly rejected *Austin*-style distortion-as-corruption and overturned BCRA's "Millionaire's Amendment," which increased contribution limits for opponents of self-financing candidates.[17]

In *Citizens United*, the Court struck down *Austin* altogether, choosing to adopt a bright-line rule rather than burden lower courts (and, ultimately, future litigants) with a balancing test: "The First Amendment does not permit laws that force speakers to retain a campaign finance attorney, conduct demographic market research, or seek declaratory rulings before discussing the most salient political issues of our day."[18] Thus, the Court held: "*Austin* should be and now is overruled. We return to the principle established in *Buckley* . . . that the Government may not suppress political speech on the basis of the speaker's corporate identity. No sufficient governmental interest justifies limits on the political speech of nonprofit or for-profit corporations."[19]

EMILY's List

A few months before *Citizens United* was decided, the D.C. Circuit handed down a broad decision overturning several FEC regulations that circumscribed the way non-profit groups spend money in politics. Although the case received less fanfare than *Citizens United*, *EMILY's List v. FEC*[20] has similarly far-reaching consequences.

The regulations in question required certain non-profit entities undertaking election-related activities to use "hard money" accounts—meaning accounts containing contributions from individuals limited to $5,000 per year—to pay for portions of activities such as get-out-the-vote efforts, voter registration activity, generic communications referencing a political party, certain administrative expenses, and advertisements referring to a federal candidate. In addition, the regulations required such nonprofits to treat as "hard money" all donations received in response to a solicitation indicating that donated funds would be used to support or oppose the election of a federal candidate.[21]

The FEC promulgated these regulations in the wake of the 2004 election, responding to sharp outcry by reform groups against the activities of non-profit groups like America Coming Together and the Swift Boat Veterans for Truth.[22] Even under the BCRA reforms, these "527 groups" (named for the section of the Internal Revenue Code exempting them from federal taxation[23]) could accept unlimited contributions from individuals and, depending on their particular activity, from corporations as well.

The regulations had major effects on groups like EMILY's List. In 2005, EMILY's List filed suit in federal court in the District of Columbia; in 2008, the district court granted the FEC's motion for summary judgment,[24] which EMILY's List appealed.

Judge Brett Kavanaugh's appellate opinion began with a detailed review of the Supreme Court's campaign finance jurisprudence.[25] Judge Kavanaugh made four observations crucial to the court's holding. *First*, campaign contributions and expenditures are protected First Amendment "speech."[26] *Second*, the Supreme Court has repeatedly ruled that the government cannot limit campaign contributions and expenditures in the name of "equalization" or "leveling the playing field."[27] *Third*, there is a cognizable governmental interest in combating quid pro quo corruption and its appearance.[28] *Fourth*, in applying this anti-corruption rationale, the Supreme Court has provided more robust protection for independent expenditures than for contributions to candidates and parties, because the former pose far less risk of quid pro quo corruption than the latter.[29]

Given these basic tenets, Judge Kavanaugh reasoned that non-profit entities like EMILY's List may not constitutionally be required to use only hard money for direct contributions to candidates and parties; such a prohibition cuts to the heart of the Supreme Court's anti-corruption rationale. But contrary to the regulations in question, non-profits may not constitutionally be compelled to use hard money when their activities are not coordinated with candidates, because such activity does not touch upon any constitutional rationale for regulation.[30]

In addition to striking down these regulations under the First Amendment, Judge Kavanaugh also agreed with EMILY's List that three of the five regulations exceeded the FEC's statutory authority.[31] Explained Judge Kavanaugh, "[T]here is a significant mismatch between these challenged provisions and the FEC's authority[.]"[32]

Finally, Judge Kavanaugh addressed the perceived unfairness of a regulatory regime that permits non-profit entities to raise and spend unlimited funds, while simultaneously requiring candidates and political parties to raise funds only in limited amounts. The correct solution, he suggested, is not to further regulate non-profits, but instead to raise or eliminate limits on contributions to parties and candidates.[33]

SpeechNow.org

SpeechNow.org v. FEC[34] was a natural extension of *EMILY's List* and *Citizens United*. In *SpeechNow.org*, the D.C. Circuit, sitting en banc, held that "the government has no anti-

corruption interest in limiting contributions to an independent expenditure group such as SpeechNow."[35]

In January 2008, the FEC issued a draft advisory opinion concluding that SpeechNow, a non-profit group intending to engage in independent expenditures expressly advocating the election or defeat of federal candidates, would be required to organize as a "political committee" and thus abide by contribution limits.[36] Instead of accepting that opinion, SpeechNow invoked 2 U.S.C. § 437h, which permits an individual to seek a declaratory judgment to determine the constitutionality of federal election laws. Pursuant to the statute, the district court certified the constitutional questions to the U.S. Court of Appeals for the District of Columbia Circuit for en banc review.[37]

In addition to holding that the FEC could not constitutionally require SpeechNow to adhere to contribution limits when raising money for independent expenditures, Judge Sentelle's opinion also held that such non-profits may constitutionally be required to adhere to FEC organizational and reporting requirements.[38] Such requirements, Judge Sentelle reasoned, did not pose a significant burden on the group: "[T]he public has an interest in knowing who is speaking about a candidate and who is funding that speech, no matter whether the contributions were made towards administrative expenses or independent expenditures."[39] Furthermore, "requiring disclosure of such information deters and helps expose violations of other campaign finance restrictions, such as those barring contributions from foreign corporations or individuals. These are sufficiently important governmental interests to justify requiring SpeechNow to organize and report to the FEC as a political committee."[40]

Republican National Committee

Under each of the above cases, political parties remain at an enormous, and growing, competitive disadvantage because they are permitted to raise and spend funds only within federal limits.

Recognizing this problem, in *Republican National Committee v. FEC*,[41] the RNC brought several as-applied challenges to BCRA's restrictions on political party fundraising. The RNC sought, among other goals, to raise and spend unlimited amounts of soft money to support state candidates in elections where *only* state candidates appear on the ballot and to support state candidates in elections where both state and federal candidates appear on the ballot.[42] The RNC argued that the First Amendment entitles it to raise and spend soft money for these activities because they are not related to a federal election. The RNC averred that it would not use federal candidates and officeholders to solicit soft money, thus eliminating any corruption concern, and that it would not help soft-money donors obtain access to federal candidates or officeholders.[43]

But a D.C. district court panel rejected these arguments, explaining that "this was the whole point of [the] soft-money ban and of the *McConnell* decision upholding it."[44] By the court's logic, the RNC was "asking us to overrule *McConnell*'s holding with respect to the ban on soft-money contributions to national political parties. As a lower court, we of course have no authority to do so."[45] More specifically, the plaintiffs could not "successfully bring an as-applied challenge to a statutory provision based on the same factual and legal arguments the Supreme Court expressly considered when rejecting a facial challenge to that provision[.]"[46]

Under BCRA, the case was heard by a three-judge district court panel and is appealable directly to the Supreme Court. On June 29, the Court affirmed the panel's ruling.[47]

Reactions and Legislation

Most of the publicity thus far has been focused on *Citizens United*, which caused considerable angst among incumbent politicians on Capitol Hill and Washington, D.C.-based reform groups. In hearings before the House Judiciary Committee, New York Congressman Jerrold Nadler assailed "the extent to which an extraordinarily activist court reached out to issue this decision."[48] Florida Congressman Alan Grayson separately predicted the complete collapse of the Republic: "The Supreme Court in essence has ruled that corporations can buy elections. If that happens, democracy in America is over."[49] Fred Wertheimer, President of Democracy 21, predicted *Citizens United* "will unleash unprecedented amounts of corporate 'influence-seeking' money on our elections and create unprecedented opportunities for corporate 'influence-buying' corruption."[50]

Robert Weissman, President of Public Citizen, went further: "Today's decision so imperils our democratic well-being, and so severely distorts the rightful purpose of the First Amendment, that a constitutional corrective is demanded."[51] Addressing the Senate Committee on Rules and Administration, Senator John Kerry echoed this sentiment, urging a constitutional amendment "to make it clear, once and for all, that corporations do not have the same free-speech rights as individuals."[52] Reflecting concerns voiced by Justice Ginsburg at oral argument,[53] and in Justice Stevens's dissent,[54] in his 2010 State of the Union address President Obama accused the Court of "revers[ing] a century of law that I believe will open the floodgates for special interests, including foreign corporations, to spend without limit in our elections," and called for legislation "to correct some of these problems."[55]

Immediately following the decision, more than a dozen bills were introduced in Congress, mostly related to the issue of foreign nationals and corporations. On February 11, Senator Charles Schumer and Congressman Chris Van Hollen held a press conference to outline forthcoming, comprehensive legislation "to pick up the pieces" after "the Supreme Court shattered nearly a century of U.S. law designed to curb the influence of corporations in our election process."[56]

Eventually, on April 29, Senator Schumer and Congressman Van Hollen introduced the Democracy Is Strengthened by Casting Light On Spending in Elections Act ("DISCLOSE Act" or "the Act").[57] President Obama "welcome[d] the introduction of this strong bi-partisan legislation to control the flood of special interest money into America's elections."[58] What follows is a summary of the House and Senate versions of the Act as they were introduced on April 29. Readers are advised that the Act is currently under consideration by Congress, and its provisions may change substantially in the course of the legislative process. The bill's prospects for passing this session were all but

eliminated at the end of July, when Senate Democrats fell short of the sixty votes needed to close debate.

Section 101 of Title I would prohibit government contractors above a $50,000 threshold from making campaign-related expenditures, and it would prohibit all TARP recipients (whether or not they are government contractors) from making any campaign-related expenditure (contributions, independent expenditures, or electioneering communications) until the TARP money is repaid. Section 102 seeks to prevent foreign influence in U.S. elections by prohibiting independent expenditures if the corporation has foreign ownership of twenty percent or more; if a majority of the board of directors are foreign nationals; or, if a foreign national "has the power to direct, dictate, or control the decision-making process of the corporation" regarding either its business or election activities.

Section 103 would restore and expand the regulations banning coordinated communications struck down under the Administrative Procedures Act in *Shays v. FEC*.[59] These regulations prohibited corporations and unions from coordinating radio and television ads with congressional candidates within ninety days of the general election and ninety days of the primary election.[60] Coordination with presidential candidates was prohibited within 120 days of a state's presidential primary election, and continuing in that state through the general election.[61] Outside of the 90-and-120-day windows, however, coordination was allowed if the ad was not merely recycled campaign material and did not use any "magic words," like "vote for."[62] Section 103 of the Act expands the types of communications by corporations and unions that can be regulated within ninety days of the primary *through* the general election. Outside of the 90-and-120-day windows, the Act also would prohibit coordination on any advertisement that promotes, supports, attacks, or opposes any candidate for federal office. Section 104 provides that the cost of any communication made by a political party on behalf of a candidate is only treated as a contribution if the candidate directed or controlled the communication.

Title II expands the definition of "independent expenditure" to include both express advocacy and its functional equivalent, and imposes a twenty-four-hour reporting requirement for expenditures over $10,000 made more than twenty days before an election, and for expenditures over $1,000 made within twenty days of an election. The Act expands the definition of an "electioneering communication," which currently includes all broadcast ads that refer to a candidate within the period beginning thirty days before the primary and sixty days before the general election. The House version would expand the period of general election coverage to 120 days; the Senate version would expand the period to begin ninety days before the primary election and running until the general election. Also, electioneering communication reports would have to contain a statement clarifying whether the communication was intended to support or to oppose the candidate. Title II also requires corporations and unions (and 527s) making aggregate independent expenditures of $10,000 or more to disclose most donors giving $1,000 or more (in the House version, $600) if the entity makes electioneering communications.

If the entity establishes a separate "Campaign-Related Activity" account, then it will only have to disclose donors to the account if the entity transferred $10,000 (or, in the House version, $6,000) or more from its general treasury to the account. Finally, CEOs of corporations or the highest ranking official of a union making independent expenditures for television commercials would have to appear on camera, like candidates, and say that he or she "approves this message." To prevent "funneling money through shell groups" like 527s and 502(c)(4)s, the CEO or highest-ranking official of the entity that is the top funder of the advertisement must make the disclaimer, and the names of the top five corporate contributors must appear on-screen at the end of the advertisement. Additionally, all registrants under the Lobbying Disclosure Act must disclose the date and amount of each electioneering communication greater than $1,000, and the name of each candidate referred to, or supported, or opposed.

Under Title III, all campaign-related expenditures made by a corporation, union, 501(c)(4) or (6) organization, or 527 group, must be disclosed on the organization's website with a clear link on the homepage within twenty-four hours of reporting such expenditures to the FEC, and in the periodic reports to shareholders. Title IV of the Senate version of the Act differs from the House version. The Senate version includes language such that if a corporation or union makes independent expenditures exceeding $50,000 supporting or opposing a candidate, then all legally-qualified federal candidates in that election (as well as national party committees) would be entitled to buy airtime at the lowest unit rate for that media market, and at a reasonable broadcast time. Finally, both the House and Senate versions of the Act provide for judicial review by the U.S. District Court for the District of Columbia; allow any Member of Congress to intervene or sue directly to challenge the DISCLOSE Act; and provide that any section of the Act that may be struck down is severable, allowing the Act's other sections to remain in force.

Predictions and Outlook

The authors of this article consulted four election law experts: Marc Elias;[63] Benjamin Ginsberg;[64] Professor Allison Hayward;[65] and Trevor Potter.[66] Below we include their complete analyses.

Q: Did the courts get it right in Citizens United and EMILY's List?

> **ELIAS:** These are two very different cases. My criticism of the Supreme Court in *Citizens United* is that the Court simply did not need to reach the corporate ban. *Citizens United* involved an as applied challenge involving unusual facts and the Court, on its own, transformed it to a challenge to the entire corporate ban. This is hardly judicial modesty or restraint. *EMILY's List* is a different story. That case was caused by the FEC over-reaching in its regulations. The DC Circuit was responding to oppressive and overbroad regulations. It was a case the FEC could have avoided if it had acted more reasonably.

GINSBERG: Absolutely. Both start with first principles and conclude that there is no such thing as too much speech. The importance of *Citizens United* in reaffirming First Amendment rights has been discussed extensively. *EMILY's List* has gotten less attention but is significant in reining in the Federal Election Commission investigations that made the process the penalty for those who exercised their First Amendment rights, especially with third party groups in 2004.

HAYWARD: Absolutely. The Court in *Citizens United* finally addressed head-on the constitutional issues presented when the government enforces a broad ban on speech based on content. In any other context, such a law would have been found unconstitutional years ago, and civil libertarians would have justly celebrated that ruling.

EMILY's List is also a welcome development, because it recognizes some limits to the reach of federal campaign finance law as against state jurisdiction.

POTTER: What we are experiencing is a decision by a current 5-4 majority of the Supreme Court to re-interpret First Amendment doctrine in the campaign finance arena, in a departure from the balance struck by the Supreme Court in *Buckley* thirty-five years ago. The new majority expresses disdain for, rather than deference to, decisions made by Congress (and, incidentally, state legislatures).

The majority ignores Congress' and the legislatures' concerns with corruption and the appearance of corruption occasioned by the presence of huge sums of money spent in the political system by interests seeking specific legislative results. This is not a "conservative" approach to judging, and will not increase public confidence in our body politic. In this regard, I am struck by the recent comments of the well-known Nixon White House official and religious writer, Chuck Colson, who was asked what the "worst thing about Washington" is today. His response was, "Today, it has been totally corrupted by money. If God has his judgment on us, it is because of special interest money, which determines how Congress acts. The political system is sick, and we need to clean up our act." It is citizen concerns such as these that led to the enactment over 100 years ago of state and federal legislation limiting corporate expenditures in candidate elections. Earlier Courts which upheld these restrictions were populated at least partially by justices themselves who had run for office and served in elective office. Today's Court, but with an ideological agenda untempered by legislative experience, has ridden rough-shod over the other branches of government to reach a result which will decrease public confidence in our democracy.

In *Citizens United* the 5-4 Supreme Court abandoned the precepts of judicial restraint to broadly decide a case that could and should have been decided on very narrow statutory grounds. Instead, the majority used the case as a weapon to overturn decades of constitutional law (most recently upheld in *McConnell* only seven years ago). The activist majority clearly couldn't bear to leave the *Austin* decision alone when they had the voting power to over-turn it. Now, they'll have to decide if they really believe their own rhetoric when presented with the inevitable subsequent constitutional challenges to restrictions on direct corporate contributions to candidates, and the foreign national ban.

In *EMILY's List*, the three-judge panel evinced its disdain for the FEC's attempts to make McCain-Feingold work and prevent circumvention of the limitations, reporting and disclosure structure Congress has established for expenditures in federal elections, over-turning a decision by a seasoned District Court judge with experience in campaign finance cases.

Q: Practically speaking, how will the decisions together affect the 2010 election cycle?

ELIAS: Taken together they will have a profound effect on the 2010 cycle. I expect we will see a much higher level of corporate spending—particularly by 501c6's (trade associations).

GINSBERG: Their greatest significance in 2010 will be for their ringing message to conservative donors that it is not only permissible to participate in the issues debate—there is a constitutional right to do so. Conservative donors largely stayed out of the fray in 2006 and 2008 due to the combination of a sour political environment and a sense of abandonment after the Bush Administration-inspired investigations of 2004 donors to the 527 groups. These decisions and an improved political environment will increase conservatives' participation in 2010. The *Citizens United* decision will also provide a greater number of vehicles with which to participate.

HAYWARD: Honestly, I think we may see some changes in the scripts used in advertising, but it would be erroneous to attribute record levels of spending in the coming cycle to the courts' decisions. It was already destined to be a huge cycle—Republicans sense that the Democrats are on the run, but the Democrats, with both houses of Congress and the White House, have leverage and the ability to attract and retain massive support.

In short, people may argue causation out of the correlation, but I think those observations are spurious.

POTTER: I expect the combination will result in significant increases in expenditures by corporations and other non-party groups seeking to elect or defeat candidates—and the source of that spending will be

virtually non-disclosed to the public (contrary to the misguided assumptions of Justice Kennedy in *Citizens United*, in attempting to mitigate the impact of his determinations).

Q: How will the decisions affect the 2012 presidential cycle and beyond?

ELIAS: It will have greatest impact and state and local elections, followed by House elections, Senate elections and then presidential. That is simply because of how much it costs to influence elections. A corporation seeking to influence a local election can do so for tens-of-thousands of dollars. Influencing a Senate election might take millions. Affecting the outcome of a presidential election would likely take many millions. Thus, I expect the greatest effect will be down ballot—though these decisions will have some, lesser, impact on presidential elections.

GINSBERG: The decisions need to be understood within the overall framework of McCain-Feingold, whose centerpiece of banning the political parties from raising or spending money legal under state law (also known as "soft money") remains intact. That means the political parties will not have the resources to compete with special interest groups in the parties' core areas—money for candidates, mobilization of voters and messaging through independent expenditures and issue ads. The main impact of allowing corporations, unions and trade associations to conduct these activities with their treasury funds is that candidates and parties will no longer be the loudest voices in their campaigns and that special interest groups will be able to fill the void using the same kind of money the parties and candidates cannot raise or spend.

HAYWARD: Again, I think we are living through a very important political era. It would be strange, given the enormous issues this Administration wants to resolve, and the policies they have chosen to resolve them, if a wide range of groups and organizations DIDN'T participate. As I said before, you can't disengage that phenomenon from whatever effect *EMILY's List* and *Citizens United* might add.

POTTER: The same as in 2010, unless Congress does something to mandate disclosure.

Q: Are the decisions likely to help or hurt one party more than the other?

ELIAS: *Citizens United* is a bad decision for both parties, period. Whether it hurts one or the other more is to be seen. But it is ultimately a bad decision for parties and for candidates.

GINSBERG: The Left's special interest groups are currently more developed and effective than the Right's, so it could benefit Democrats unless the Right can make up the deficit as quickly and effectively as it did with 527s in 2004. Remember that the Democrats have long relied on outside groups while Republicans developed a much stronger Party apparatus. With McCain-Feingold sapping the Parties, the Left's combination of nonprofit organizations and wealthy individuals is a better model than what the Right currently has. Advantage to the Democrats until either the Right catches up or the parties can start raising and spending soft dollars.

HAYWARD: Generally speaking, in the short run deregulation tends to benefit unions and thus Democrats, because they are more comfortable with taking bold new approaches and are undeterred by any potential loss in market goodwill. To the extent that those states that prohibited corporate and union expenditures are also locations with strong unions, changes in those laws will reinforce this general trend.

POTTER: I think it's too early to tell—except that it will greatly strengthen the hands of economic interests (both business and labor) seeking to affect legislation.

Conclusion

As the 2010 election season shifts into high gear, the effects of these four cases will start to become clearer. Of course, as soon as the regulated community is comfortable within the new contours, the law could change again. Noteworthy cases are pending in district courts across the country; legislative and administrative bodies are actively considering "fix" legislation and regulations.

As always, political actors and issue groups seeking to exercise their full rights while avoiding legal landmines are advised to pay close attention to these upcoming developments.

Endnotes

1 130 S. Ct. 876 (Jan. 21, 2010).

2 494 U.S. 652 (1991).

3 Buckley v. Valeo, 424 U.S. 1, 44 n.52 (1976) (per curiam).

4 130 S. Ct. at 890.

5 The Court also declined to exempt *Hillary* from the strictures of BCRA because it was released in a video-on-demand format, or "to carve out an exception to 441b's expenditure ban for non-profit corporate political speech funded overwhelmingly by individuals." *See id.* at 890-92.

6 *See* 34 Stat. 864 (Jan. 26, 1907).

7 130 S. Ct. at 900-01.

8 2 U.S.C. § 441b.

9 *See, e.g.*, McConnell v. FEC, 540 U.S. 93, 206 (2003).

10 2 U.S.C. § 441b(a).

11 *Id.* § 434(f)(3)(A).

12 *See McConnell*, 540 U.S. at 206 ("[P]laintiffs argue that the justifications that adequately support the regulation of express advocacy do not apply to significant quantities of speech encompassed by the definition of electioneering communications. This argument fails to the extent that the issue ads broadcast during the 30- and 60-day periods preceding federal primary and general elections are the functional equivalent of express advocacy. The justifications for the regulation of express advocacy apply equally to ads aired during those periods if the ads are intended to influence the voters' decisions and have that effect.").

13 Brief of Appellee Federal Election Commission at 24, Citizens United v. FEC, No. 08-205 (Feb. 17, 2009).

14 *See* 424 U.S. at 39-51.

15 *See id.* at 45.

16 *Austin*, 494 U.S. at 660.

17 *See* Davis v. FEC, 128 S. Ct. 2759 (June 26, 2008).

18 130 S. Ct. at 889.

19 *Id.* at 913 (citations omitted).

20 581 F.3d 1 (2009).

21 *Id.* at 16-19.

22 *Id.* at 4-7.

23 *See* 26 U.S.C. § 527.

24 *See* EMILY's List v. FEC, 569 F. Supp. 2d 18 (D.D.C. 2008).

25 581 F.3d at 5.

26 *Id.*

27 *Id.* at 5-6.

28 *Id.* at 6.

29 *Id.* at 6-7.

30 *Id.* at 16-18.

31 *Id.* at 19.

32 *Id.* at 21.

33 *Id.* at 19.

34 599 F.3d 686 (D.C. Cir. Mar. 26, 2010).

35 *Id.* at 695.

36 *Id.* at 689-90.

37 *Id.* at 690.

38 *Id.* at 696-98.

39 *Id.* at 698.

40 *Id.*

41 698 F. Supp. 2d 150 (D.D.C. 2010).

42 *Id.* at 154-55.

43 *Id.* at 155.

44 *Id.* at 157.

45 *Id.*

46 *Id.*

47 Republican Nat'l Comm. v. FEC, *aff'd without opinion*, 2010 U.S. LEXIS 5530 (June 29, 2010).

48 *Campaign Finance Reform: Hearing Before the Subcomm. on Constitution, Civil Rights, and Civil Liberties of H. Comm. on the Judiciary*, 111th Cong. (Feb. 3, 2010) (opening Statement of Hon. Jerrold Nadler).

49 *Reaction: Supreme Court's Campaign Finance Ruling*, Associated Press, Jan. 21, 2010.

50 *Id.*

51 *Id.*

52 *Corporate America v. The Voter: Examining the Supreme Court's Decision to Allow Unlimited Corporate Spending in Elections: Hearing Before the S. Comm. on Rules and Administration*, 111th Cong. (Feb. 2, 2010) (statement of Hon. John F. Kerry).

53 Transcript of Oral Argument at 4-5, Citizens United v. FEC (Reargued), No. 08-205 (Sept. 9, 2009).

54 130 S. Ct. at 947-48.

55 *President Obama Delivers State of the Union Address*, CQ Transcriptions, Jan. 27, 2010. Under federal law, foreign nations may not contribute to federal candidates or parties, or make independent expenditures that refer to federal candidates. 2 U.S.C. § 441e. FEC regulations prohibit foreign nationals from participating, directly or indirectly, in any way in the decision-making process of any corporation, labor union or political committee in its election-related activities. 11 C.F.R. § 110.20(i). *Citizens United* did not overturn these provisions.

56 *Sen. Charles E. Schumer, D-N.Y., and Rep. Christopher Van Hollen, D-MD., Hold a News Conference on the Citizens United v. FEC Ruling*, CQ Transcriptions, Feb. 11, 2010.

57 H.R. 5175, 111th Cong. (2010); S. 3295, 111th Cong. (2010).

58 *See Statement by the President on the DISCLOSE Act*, Apr. 29, 2010, available at http://www.whitehouse.gov/the-press-office/statement-president-disclose-act (last accessed Aug. 16, 2010).

59 528 F.3d 914, 925 (D.C. Cir. 2008).

60 *See id.* at 921-22 (quoting 11 C.F.R. § 109.21(c)(4)(i)).

61 *Id.* (quoting 11 C.F.R. § 109.21(c)(4)(ii)).

62 *Id.* (quoting 11 C.F.R. § 109.21(c)(2)-(3)).

63 E-mail from Marc Elias to Kathryn Biber (Mar. 28, 2010, 15:29 MDT) (on file with authors). Marc Elias is a partner at Perkins Coie LLP in Washington, D.C. He specializes in representing public elected officials, candidates, parties, corporations, and PACs in connection with campaign finance, ethics, and white-collar criminal defense matters. He recently served as lead counsel for Senator Franken in the 2008 Minnesota Senate election recount and contest—the largest recount and contest in American history. In 2004 he served as General Counsel to the Kerry-Edwards presidential campaign. He served in that same capacity for Chris Dodd for President during the 2008 primary campaign.

64 E-mail from Benjamin Ginsberg to Kathryn Biber (Mar. 22, 2010, 13:18 MDT) (on file with authors). Ben Ginsberg is a partner at Patton Boggs LLP in Washington, D.C. He represents numerous political parties, political campaigns, candidates, Members of Congress and state legislators, governors, corporations, trade associations, vendors, donors, and individuals participating in the political process. In 2004 and 2000, Mr. Ginsberg served as national counsel to the Bush-Cheney presidential campaigns; he played a central role in the 2000 Florida recount. In 2008, he served as national counsel to Romney for President.

65 E-mail from Allison Hayward to Kathryn Biber (Mar. 22, 2010, 08:59 MDT) (on file with authors). Allison Hayward is an Assistant Professor of Law at George Mason University School of Law. She also serves on the Boards of the Center for Competitive Politics and of the Office of Congressional Ethics.

66 E-mail from Trevor Potter to Kathryn Biber (Apr. 9, 2010, 14:37 MDT) (on file with authors). Trevor Potter is a partner at Caplin & Drysdale in Washington, D.C., and a former Commissioner and Chairman of the FEC. Mr. Potter is also the President and General Counsel of the Campaign Legal Center, a Washington D.C. non-profit which has participated in numerous campaign reform cases as Counsel to the congressional sponsors of BCRA. He advises corporations, nonprofit organizations, and candidates on structuring new political efforts and administering their political, lobbying, and issue-advocacy projects. Mr. Potter served as General Counsel to the John McCain 2008 campaign and also held that position with the McCain 2000 campaign.

The Potential Impact on Campaign Finance Regulation of *SpeechNow.org v. FEC*

By Douglas Chalmers, Jr. and Michael Jablonski***

The decision of the U.S. Court of Appeals for the District of Columbia Circuit in *SpeechNow.org v. Federal Election Commission*[1] may augur a sea-change in the law governing campaign finance regulation. This article discusses the statutory and jurisprudential context in which the SpeechNow.org challenge to federal campaign finance laws developed; presents an overview of the decision of the Court of Appeals; and notes the potential implications of the decision for the future case law addressing the intersection of campaign finance law and the First Amendment.

I. The Conflict Between Campaign Finance Regulation and the First Amendment

The *SpeechNow.org* case raises issues that have been central to campaign finance litigation since the passage of the Federal Election Campaign Act of 1971 ("FECA"),[2] and more particularly since the passage of the Bipartisan Campaign Reform Act of 2002 ("BCRA"),[3] i.e., the morphing of money into speech; the nature of the interest that government must have in order to limit political speech; the question of applying strict or intermediate scrutiny as the constitutional standard of review; and the theoretical distinctions in the treatment of contributions and expenditures. In order to understand the significance of the *SpeechNow.org* decision on these issues, it is necessary to understand generally the background of campaign finance regulation, as well as a few of the seminal cases challenging those regulations on First Amendment grounds.

FECA imposed strict disclosure requirements on federal candidates, as well as on independent groups and political parties participating in federal elections. The 1972 election, marked by financing tactics many thought questionable, motivated Congress to amend FECA in 1974 by establishing strict limits on contributions by political parties and independent participants, including individuals and political action committees ("PACs"). Congress also created the Federal Election Commission ("FEC") as an independent enforcement agency that warehoused and made public disclosure reports. These reforms, enacted over a veto by President Gerald Ford, not only limited the amount an entity could contribute, but it also limited the amount that could be spent, including even the amounts that could be spent by a candidate out of his or her personal funds.

The spending limitations went too far. In 1976 the Supreme Court, in a *per curiam* opinion in *Buckley v. Valeo*,[4] upheld limits on campaign contributions by individuals but struck down provisions limiting campaign spending by candidates and by independent groups. The Court also struck down the provisions limiting the amount of money a candidate could spend on campaigns from purely personal funds.

Buckley confirmed the important idea that money equals speech, thereby bringing the use of money for political purposes within the protection of the First Amendment.[5] *Buckley* held that campaign finance limitations impinge on fundamental constitutional interests since the effect of limits is to regulate the political process.[6] The principal question, as framed by *Buckley* and as applied in subsequent campaign finance litigation, is whether a sufficient governmental interest exists to justify restricting application of the First Amendment.

In *Buckley* and in subsequent decisions, the Court has focused on three potential government interests that might justify campaign finance regulations: preventing corruption or its appearance; promoting parity in political speech by eliminating a supposed advantage enjoyed by the wealthy; and increasing the number of people able to run for office by controlling skyrocketing costs.[7] Of these, preventing corruption is the only one which has continued to be the touchstone supporting most regulation, and—as explained below—the only one currently held to be a valid government interest.

Buckley quickly disposed of the argument that creating equality in speech or campaigns is a valid constitutional consideration. The Court noted:

> [T]he mere growth in the cost of federal election campaigns in and of itself provides no basis for governmental restrictions on the quantity of campaign spending and the resulting limitation on the scope of federal campaigns. The First Amendment denies government the power to determine that spending to promote one's political views is wasteful, excessive, or unwise.[8]

The Court again explicitly rejected equalization of political opportunities as a justification in *Davis v. FEC*,[9] and it reiterated in *Citizens United v. FEC*[10] that the supposed chilling effect of great wealth is insufficient to justify a burden on First Amendment rights.

On the corruption interest, however, *Buckley* cited certain "deeply disturbing examples" in the 1972 election to find that quid pro quo corruption justified some regulation of political speech.[11] It further held that Congress could conclude that the avoidance of undue influence in politics is critical to fostering confidence in a representative government.[12]

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In applying the corruption rationale, *Buckley* drove a theoretical wedge between the treatment of contributions and expenditures in the world of campaign finance regulation. The Court concluded that, because any form of mass communication requires expenditure, limits on expenditures impose a substantial, rather than theoretical, restraint on both the amount and the diversity of political speech.[13] The Court found that limitations on expenditures violated rights of expression and of association, and that the government had no countervailing interest that would justify limitations on those First Amendment rights.

The justification advanced in support of the limitation on independent expenditures—the potential for corruption and the appearance of impropriety—was found in *Buckley* not to "satisfy the exacting scrutiny applicable to limitations on core First Amendment rights of political expression."[14] The Court held that limitations on campaign expenditures were subject to a high degree of constitutional scrutiny.[15]

The Court felt, by contrast, that limits on contributions did not constitute a substantial restraint on political expression because donating money to a campaign is a general expression of support that does not transmit the underlying basis for the support. It concluded that the act of contributing, but not the amount of the contribution, was the speech at issue, so there would be no direct restraint on political expression.[16] In addition, the Court relied on the contention that limiting donations does not limit speech since the actual communication is done by someone other than the donor.[17] The Court also noted that, because donors may also spend unlimited amounts independent of a campaign, this acts as a safety valve giving contributors an outlet for expression using amounts in excess of the limits.[18]

FECA limitations on the amounts that individuals could contribute to multicandidate PACs were subsequently upheld in *California Medical Ass'n v. FEC*.[19] CalMed sought to frame the limitation as a restriction on expenditures, arguing that the limitation limited the ability of the organization to make expenditures. The Court found the statute to be, "strictly speaking," a contribution limitation "qualitatively different from the contribution restrictions we upheld in *Buckley*."[20] The Court reasoned that, since contributions by an organization to a PAC are significantly different than independent expenditures made by individuals, the degree of constitutional protection should also be different. The Court concluded that, if the rights of an individual are not unconstitutionally limited by restrictions on the amount that can be given a candidate, then the amount a single entity can give to a multicandidate PAC can similarly be limited.[21]

In 1985, the $1,000 limitation on independent expenditures on behalf of presidential candidates fell based upon a lack of evidence that the expenditures tended to foster either corruption or the appearance of corruption. In *National Conservative Action Political Committee v. FEC* (*NCPAC*), the Supreme Court held that the limitation on its face violated rights to speak freely and to associate.[22] *NCPAC* differed from *California Medical*, according to the Court, because it dealt with limitations on expenditures by PACs rather than contributions.[23] The Court also concluded that NCPAC, a formally incorporated organization, was entitled to First Amendment protection for political activities, a position later strengthened in *Citizens United*.[24]

In more recent cases, the Court has treated independent expenditures and coordinated spending by political parties differently in twin cases arising out of Colorado. In *FEC v. Colorado Republican Federal Campaign Committee* (*Colorado I*),[25] limitations on independent expenditures made by the Colorado Republican Party in a Senatorial race were stricken because truly independent expenditures by parties do not foster corruption any more than independent expenditures by individuals. On the other hand, the Court upheld limitations on coordinated spending by political parties in *FEC v. Colorado Republican Federal Campaign Committee* (*Colorado II*).[26] Finding that contributions to political parties could be a way to avoid limitations on contributions to candidates, the Court concluded that there was little evidence that limitations frustrated the right of political parties to participate in elections.

In 2002, almost thirty years after *Buckley*, Congress ventured to impose new campaign finance limitations, this time extending restrictions to the use of soft money and to the communication of issue advocacy ads. BCRA restricted contributions to national political parties, limited "electioneering communications" or issue ads by independent groups shortly before elections, and established a new set of contribution limits for campaigns running against self-funded candidates.

BCRA was quickly challenged on constitutional grounds, but it was upheld in *McConnell v. FEC*.[27] In that case, the Supreme Court repeated the distinction between contributions and expenditures established in *Buckley*. The Court concluded that soft money could be restricted because the government's interest in "preventing 'both the actual corruption threatened by large financial contributions and the eroding of public confidence in the electoral process through the appearance of corruption'" outweighed "limited burdens" imposed on the First Amendment.[28]

McConnell applied a "potential for corruption" test to the question of whether contributions to national parties could result in unreasonable access to lawmakers.[29] In so doing, *McConnell* strayed from *Buckley*'s emphasis on quid pro quo corruption. The Court gave significant judicial deference to Congress's purported "ability to weigh competing constitutional interests in an area in which it enjoys particular expertise."[30]

The years following *McConnell* saw changes in the Court's membership, including the ascension of John Roberts as Chief Justice. In one of its first campaign finance cases, *Randall v. Sorrell*,[31] the Roberts Court took a fractured stance on First Amendment issues. The case invalidated a Vermont statute that imposed severe limits on political contributions, campaign expenditures, and independent expenditures. A plurality of the Court found that *Buckley* prevented any limitations on campaign expenditures, and that limitations on campaign contributions, although constitutionally permissible as a general matter, could be so drastic as to violate First Amendment free speech principles. The plurality opinion

reaffirmed *Buckley* on *stare decisis* grounds. The opinions, as a whole, signaled that future changes in campaign finance jurisprudence could be expected.

This trend continued in 2007, when BCRA provisions preventing the use of corporate funds for independent political advertising in the sixty-day period before an election were found to be overly broad and to unduly restrict free speech rights. In *FEC v. Wisconsin Right to Life*,[32] the Court found that issue ads that do not expressly advocate for a candidate in an election could not be restricted as either an attempt to prevent corruption or limiting effects of large corporate expenditures. The Court clarified that *McConnell* did not hold that any ad intending to influence an election constituted express advocacy. The Court further created a test under which an ad is the functional equivalent of express advocacy only "only if the ad is susceptible of no reasonable interpretation other than as an appeal to vote for or against a specific candidate."

In 2008, in *Davis v. FEC,*[33] the Court again addressed issues related to the intersection of campaign finance regulation and the First Amendment. The issue in that case was BCRA's "millionaire's amendment," which provided different contribution and disclosure rules if any candidate in an election spent $350,000 or more of his or her own money. This amendment clearly discriminated against candidates who chose to spend their own money. The Court concluded that the provision could not prevent actual or threatened corruption since there was little chance that a candidate could be corrupted by unlimited expenditure of his or her own funds. In addition, the Court reiterated that a desire to create parity between competing campaigns was insufficient to justify limiting First Amendment rights. Having found in *Randall* that setting too low a limit could be constitutionally infirm, the Court specifically said that there was no constitutional basis for attacking a restriction as too high.

II. The SpeechNow.org Challenge

In this context, the *SpeechNow.org* case represented the next logical step in the challenge to FECA and BCRA on First Amendment grounds. In effect, SpeechNow.org sought to challenge the requirement that individuals who band together to pool their resources to fund independent expenditures must register as a political committee and become subject to all the limitations and reporting requirements applicable to such committees.

A. Statutory Obligations and Limitations on Political Committees

Under federal law, a "political committee" is "any committee, club, association, or other group of persons" that receives contributions, or makes expenditures, of more than $1,000 in a year.[34] Any group which is designated as a "political committee" is subject to strict contribution limits. In particular, contributions to political committees are limited to $5,000 per calendar year, and individuals may not give more than $69,900 biennially to all political committees.[35] These limits, of course, severely restrict the ability of individuals to get together to pool resources and fund independent expenditures in connection with federal elections.

In addition to the contribution limits, a political committee is also required to comply with certain record-keeping and reporting requirements.[36] These requirements include appointing a treasurer; maintaining records for three years that include identifying information about contributors and details on expenditures; registering with the FEC; and filing regular disclosure reports providing details on the committee's finances and operations.[37]

B. The Establishment of SpeechNow.org to Challenge These Statutes

SpeechNow.org was established to create a test case on the validity of the political committee regulations as applied to groups of individuals who band together to fund independent expenditures. In order to accomplish this goal, David Keating, the other founders of SpeechNow.org, and their legal team made a number of well-thought-out tactical decisions designed to narrow the focus of their First Amendment challenge to the statute.

Keating established SpeechNow.org as an unincorporated section 527 political organization with a stated mission of "promot[ing] the First Amendment rights of free speech and freedom to assemble by expressly advocating for federal candidates whom it views as supporting those rights and against those whom it sees as insufficiently committed to those rights."[38] In order to "avoid any of the concerns the Supreme Court has raised about corruption,"[39] the organization's bylaws were drafted to permit contributions only from individuals, and to preclude SpeechNow.org from coordinating its expenditures with any candidates or political parties. In addition, the bylaws prohibited SpeechNow.org from accepting contributions from any of the entities which are prohibited from making contributions to federal candidates (corporations, unions, federal government contractors, etc.). SpeechNow.org also made it clear that it intended solely to make independent expenditures and would not contribute to candidates.[40]

SpeechNow.org was also established as an unincorporated association with a single purpose, and it noted that some of its solicitations would refer to particular candidates for federal office by name.[41] This fact allowed SpeechNow.org to assert that contributors necessarily intended for their contributions to be used to further SpeechNow.org's goals. As such, the government could not argue that it had an interest in protecting the interests of shareholders who might not agree with the organization's decision to support or oppose certain candidates.

The SpeechNow.org challenge to the statute was also an as-applied challenge, rather than a facial challenge. SpeechNow.org also included as plaintiffs in the case prospective contributors who wanted to give both more than $5,000 and less than $5,000 to the organization, which helped ensure that interests of the parties before the court squarely presented the constitutional question on which SpeechNow.org wanted a ruling.

C. SpeechNow.org Seeks an Advisory Opinion and Initiates Litigation

In November 2007, before litigating the issues, SpeechNow.org requested an advisory opinion from the FEC. The request presented three basic questions: (1) whether SpeechNow.org had to register as a political committee; (2) whether donations to SpeechNow.org are "contributions" subject to the federal contribution limit to political committees; and (3) whether an individual must count his donations to the group among the contributions applicable to his biennial aggregate contribution limit described in 2 U.S.C. § 441a(a)(3).[42]

At that time, however, the FEC lacked a quorum, and as such it could not issue an opinion. The FEC's general counsel did, however, issue a draft advisory opinion that concluded that SpeechNow.org would qualify as a "political committee" and thus would be subject to the contribution limits and reporting requirements applicable to such committees. In short, the FEC's general counsel concluded that Mr. Keating and other individuals would violate federal law if they contributed more than $5,000 per year to SpeechNow.org to fund purely independent expenditures.

With this draft advisory opinion in hand, SpeechNow.org filed a complaint and a motion for preliminary injunction. In its complaint, SpeechNow.org challenged the merits of the contribution limits and the administrative and continuous reporting requirements. In its motion for injunctive relief, and in order for SpeechNow.org to be able to participate fully in the 2008 elections, SpeechNow.org sought only to enjoin application of the contribution limits.

In its case before the district court, SpeechNow.org argued that, because the government has no legitimate interest in regulating independent expenditures—a basic premise of the Supreme Court decision in *Buckley v. Valeo*—the government also necessarily has no interest in regulating contributions made to committees which will use those funds solely to fund independent expenditures. In other words, SpeechNow.org attempted to extend *Buckley's* reasoning not just to independent expenditures, but also to contributions made to groups to fund those expenditures.

SpeechNow.org also argued that FECA improperly requires individuals to choose between their First Amendment rights of freedom of speech and freedom of association. In particular, it noted that while individuals are free to exercise their freedom of speech by making unlimited independent expenditures, and while they are also free to associate with other individuals to form political committees to make independent expenditures, under FECA they could not do both at the same time. If individuals associated together to form a group, then none of them could contribute more than $5,000 annually to fund the group's expenditures. SpeechNow.org argued forcefully that this infringed on each individual's First Amendment rights, as well as that of the group itself.

The district court denied the motion for injunctive relief on July 1, 2008. The court, applying a broad definition of "corruption," concluded that the government had a legitimate interest in regulating contributions made to political committees that make only independent expenditures. Applying an intermediate scrutiny standard of review, the court concluded that SpeechNow.org did not have a likelihood of success on the merits, and thus denied the motion for an injunction.

Unsurprisingly, SpeechNow.org appealed the district court's decision. Pursuant to 2 U.S.C. 437h, the district court also certified five issues to the court of appeals for resolution in the merits case.

D. The Supreme Court Decides Citizens United

While this appeal was pending, the Supreme Court issued its important opinion in *Citizens United.*[43] Inasmuch as that decision is the subject of another article in the same issue of this publication, it will not be discussed in detail here. It is necessary for present purposes, however, to note two of the key holdings issued by that decision.

First, the Court reaffirmed *Buckley*, holding that the only type of corruption that may give rise to a government interest in regulating speech is quid pro corruption. Second, the Court confirmed that, by definition, independent expenditures do not give rise to such corruption. As such, the Court ruled that Congress may not impose limitations on independent expenditures made by corporations, and invalidated BCRA provisions that restricted such expenditures.

E. SpeechNow.org*: The Court of Appeals Ruling*

The Supreme Court's reasoning in *Citizens United* of course had a major impact on the U.S. Court of Appeals for the District of Columbia in *SpeechNow.org*. *Citizens United* did not, however, squarely resolve the fundamental issue presented in *SpeechNow.org*, i.e., whether the fact that the government may not constitutionally limit independent expenditures also means that it may not limit contributions made solely to fund such expenditures.

In ruling on this question, the court of appeals extended the Supreme Court's *Citizens United* rationale in precisely the manner requested by SpeechNow.org. Specifically, the court ruled that, if the government has no legitimate anti-corruption interest in limiting independent expenditures, it can have no legitimate anti-corruption interest in limiting contributions made for the purpose of funding such expenditures. It thus held that the contribution limits on political committees are unconstitutional as applied to individual contributions to SpeechNow.org.

This ruling is particularly important for conceptual purposes, because the court effectively applied the *Buckley* and *Citizens United* reasoning on expenditures to contributions. In so doing, it effectively limited the validity of *Buckley's* analysis of the rationale on contribution limits to contributions made to candidates. This potentially has far-reaching implications, the full extent of which will not be known for some time.

The *SpeechNow.org* decision recognizes that using different constitutional standards to evaluate contributions and expenditures, as was done in *Buckley*, fails to address situations where accepting contributions and making expenditures are necessarily intertwined and are, indeed, part and parcel of the same act. Quite clearly, meaningful

expenditures cannot be made by a political organization unless significant contributions are made to it. In this case, as noted above, SpeechNow.org will be funded primarily by individuals actually speaking through the entity they have created, which is conceptually distinct from the situation discussed in *Buckley*, in which the Court concluded that the actual speech will be accomplished by someone other than the donor. In addition, while there may be various media available to the SpeechNow.org donors through which they can engage in political speech, a factor *Buckley* used to justify a restriction on contributions, most individual donors cannot use expensive television and other mass media without combining their resources.

The conceptual problems posed by applying different constitutional standards to contributions and expenditures was, in fact, anticipated by various Justices writing in *Buckley*. Chief Justice Burger, for example, asserted that contributions and expenditures were "two sides of the same First Amendment coin."[44] Justice Blackmun wrote that "I am not persuaded that the Court makes, or indeed is able to make, a principled constitutional distinction between the contribution limitations, on the one hand, and the expenditure limitations, on the other, that are involved here."[45] Justice White saw wisdom in controlling both contributions and expenditures, noting:

> [I]t would make little sense to me, and apparently made none to Congress, to limit the amounts an individual may give to a candidate or spend with his approval but fail to limit the amounts that could be spent on his behalf. Yet the Court permits the former while striking down the latter limitation.[46]

Related concerns have been expressed in more recent opinions, and by Justices with different philosophical approaches to the analysis of campaign finance regulation. For example, Justice Thomas, in a dissent joined by Justice Scalia, has challenged the notion that contributions should be afforded less constitutional protection than expenditures.[47] As he argued, "[C]ontributions to political campaigns generate essential political speech. And contribution caps, which place a direct and substantial limit on core speech, should be met with the utmost skepticism and should receive the strictest scrutiny."[48]

It remains to be seen what the full extent will be of the court of appeals reasoning and decision in *SpeechNow.org*, but the implications for campaign finance regulation are potentially far-reaching. For example, as a theoretical matter, the reasoning of the court of appeals would seem to undermine the validity of the soft money rules. In *SpeechNow.org*, the Court was dealing with independent expenditures, which are defined under federal law to exclude expenditures made by political parties. Nonetheless, the Court's basic reasoning—i.e., that if expenditures for a certain purpose may not be constitutionally limited, then contributions made to fund those expenditures also may not be constitutionally limited—would seem to have application in this context. Unless there is some federal quid pro quo corruption interest that justifies preventing unlimited party expenditures for redistricting, party building, and state and local elections, one would think there should be no limits on such expenditures. If there can be no limits on such expenditures, then under *SpeechNow.org* there would also seem to be no constitutional basis for limiting contributions made to political parties for that purpose.

This issue was recently addressed in *Republican National Committee v. FEC*.[49] In that case, the federal district court declined to strike down the soft money ban, holding that it did not have the authority to overturn the portion of *McConnell* which previously had upheld these restrictions. In a very recent decision, the Supreme Court summarily affirmed this decision. In so doing, however, three Justices indicated that they would have preferred to hear the appeal.

It remains to be seen whether this issue will be revisited in future cases. It does seem clear, however, that the reasoning of the court of appeals will be relied upon in other challenges to campaign finance regulations. This is particularly true given that the Solicitor General and the FEC have decided against asking the Supreme Court to review the court of appeals decision, meaning that the decision on the merits of the contribution issue will stand.[50]

As a practical matter, it is also clear that the decision will have an impact on the 2010 elections. The FEC issued two advisory opinions in July approving requests by the Club for Growth and the Commonsense Ten, a pro-Democratic group, for permission to raise unlimited funds and make unlimited expenditures in federal campaigns. Both groups agreed to disclose donors and spending. In addition, at least twenty-three groups have now informed the FEC that they intend to raise unlimited amounts and make unlimited expenditures in connection with the 2010 elections.[51]

F. SpeechNow.org*: The Court of Appeals Ruling on the Administrative and Reporting Requirements, and the Potential Implications on Anonymous Political Speech*

While invalidating the contribution limits as applied to SpeechNow.org, the court of appeals did conclude that SpeechNow.org must comply with the reporting and organization requirements required of political committees. As was also noted in *Buckley*, the court concluded that disclosure requirements fill a justifiable governmental interest of providing the electorate with information about sources and uses of political money; deterring actual and potential corruption by exposing large contributions to public review; and facilitating detection of violations of contribution restrictions.[52]

Disclosure requirements constrain speech to a lesser extent than do contribution and expenditure regulations. The Supreme Court has suggested that they do not prevent anyone from speaking.[53] In contrast to the strict scrutiny standard *Buckley* employed in evaluating disclosure requirements, subsequent decisions do not limit acceptable governmental interests to anti-corruption alone. Any sufficiently important governmental interest with a substantial relation to the disclosure requirement will suffice.[54] Reporting and disclosure requirements survived facial challenges in *Buckley* and *Citizens United*, and they survived the as-applied challenge in *SpeechNow.org*.

The Supreme Court has not yet addressed the question whether groups making independent expenditures have a

right to anonymous speech. In *McIntyre v. Ohio Elections Commission*, the Supreme Court struck down a law requiring that leaflets be signed by the author as inhibiting First Amendment rights.[55] Ohio asserted that it had an interest in preventing false, misleading or libelous statements. Justice Stevens, writing for the majority, analyzed the long history of anonymous political speech, concluding that neither the state's informational interest nor its desire to circumscribe fraud justify the restriction on speech.[56] Numerous courts have subsequently invalidated state statutes regulating anonymous speech.[57] Eight states have had statutes declared unenforceable by their attorney general.[58]

The question in a situation like *SpeechNow.org* is whether, even under the slightest standard, disclosure requirements for an organization engaged in independent expenditure is acceptable. The potential for corruption is virtually non-existent. The value to voters of information on SpeechNow.org is minimal. This is another area in which future campaign finance litigation can be expected. In the interim, the FEC has advised that it will undertake rule-making proceedings to address the reporting requirements in light of *Citizens United* and *SpeechNow.org*.

One final likely consequence of the decision is worth mentioning. Given that the court upheld the reporting requirements but abrogated the contribution limits, it seems fairly likely that the FEC will in coming months seek to require many more entities and organizations to register and file disclosure reports with the FEC on the ground that their "major purpose" is political campaign activity.

III. Conclusion

For a number of reasons, the *SpeechNow.org* decision represents an important development in campaign finance litigation. The case is one of many in which the provisions of BCRA have been gradually scaled back or invalidated on the ground that campaign finance reformers have, in their zeal to regulate campaign spending, gone too far in infringing on the ability of individuals and groups to exercise First Amendment rights. It remains to be seen whether the court's principal ruling that, if expenditures may not be limited, contributions to fund those expenditures may also not be limited, receives wider application in the campaign finance jurisprudence.

Endnotes

1 599 F.3d 686 (D.C. Cir. 2010).

2 Pub. L. 92-225, 86 Stat. 3, enacted February 7, 1972, 2 U.S.C. § 431 et seq.

3 Pub. L. 107-155, 116 Stat. 81 (codified in scattered sections of 2 U.S.C.). BCRA is also known as McCain-Feingold, after its chief sponsors in the Senate. Ironically, the House version, H.R. 2356 introduced by Christopher Shays (R-CT), became law instead of the Senate bill.

4 424 U.S. 1 (1976).

5 *See, e.g.,* J. Skelley Wright, *Money and Pollution of Politics: Is the First Amendment an Obstacle to Political Equality?* 82 Colum. L. Rev. 609 (1982).

6 424 U.S. at 23. The Court identified both the First and Fourteenth Amendments as sources of associational rights.

7 *Id.* at 26.

8 *Id.* at 57.

9 128 S. Ct. 2759, 2773 (2008).

10 130 S. Ct. 876, 902 (2010).

11 424 U.S. at 27.

12 *Id.* at 28.

13 *Id.* at 19.

14 *Id.* at 44-45. The Court used the same analysis to strike down limitations on use of personal funds. *Id.* at 52.

15 *Id.* at 19. *See also Nixon v. Shrink Missouri Government PAC*, 528 U.S. 377, 387-88 (2000); *FEC v. Beaumont*, 539 U.S. 146 (2003).

16 424 U.S. at 21.

17 *Id.*

18 *Id.* at 44-45.

19 453 U.S. 182 (1981). In addition to a First Amendment challenge, CalMed asserted an equal protection violation based upon the Fifth Amendment. The Court found that differential treatment of individuals and organizations reflected congressional judgment based upon the different structures and goals of donors.

20 *Id.* at 195.

21 *Id.* at 197.

22 470 U.S. 480 (1985).

23 *Id.* at 495.

24 *Id.* at 496.

25 518 U.S. 604 (1996).

26 533 U.S. 431 (2001).

27 540 U.S. 93 (2003).

28 *Id.* at 94-95 (quoting *FEC v. National Right to Work Comm.*, 459 U.S.197, 208 (1982)).

29 "[L]arge soft-money donations to national party committees are likely to buy donors preferential access to federal officeholders no matter the ends to which their contributions are eventually put. . . . Congress had sufficient grounds to regulate the appearance of undue influence associated with this practice." *Id.* at 156.

30 *Id.* at 95.

31 548 U.S. 230 (2006).

32 551 U.S. 449 (2007).

33 128 S.Ct. 2759 (2008).

34 2 U.S.C. § 431(4).

35 2 U.S.C. §§ 441a(a)(1)(C) and 441a(a)(3).

36 2 U.S.C. §§ 432, 433, and 434(a).

37 *Id.*

38 *SpeechNow.org v. FEC*, 599 F.3d 686, 689 (D.C. Cir. 2010).

39 Appellant's August 24, 2009 Brief at 4.

40 FECA defines an independent expenditure to be an expenditure "expressly advocating the election or defeat of a clearly identified candidate" that is "not made in concert or cooperation with or at the request or suggestion of such candidate, the candidate's authorized political committee, or their agents, or a political party committee or its agents." 2 U.S.C. § 431(17).

41 Appellant's August 24, 2009 Brief at 7.

42 Appellant's August 24, 2009 Brief at 15.

43 Citizens United v. FEC, 130 S.Ct. 876 (2010).

44 Buckley v. Valeo, 424 U.S. 1, 241 (1976) (opinion of Burger, C.J.).

45 424 U.S. at 290 (opinion of Blackmun, J.).

46 *Id.* at 260-62 (opinion of White, J.).

47 Nixon v. Shrink Mo. Gov't PAC, 528 U.S. 377, 410 (Thomas, J., dissenting).

48 *Id.* at 412.

49 *See* Republican Nat'l Comm. v. FEC, 698 F. Supp. 2d 150 (D.D.C. 2010), *aff'd*, 130 S.Ct. 3544 (2010).

50 SpeechNow, caught by surprise by that decision, has filed a petition for certiorari to address lingering questions as to the reporting, disclosure, and registration rules.

51 The Center for Public Integrity, PaperTrail The Center Blog, MONEY & POLITICS: Despite Court Win After Citizens United, SpeechNow.Org Yet to Capitalize, http://www.publicintegrity.org/blog/entry/2386 (Sept. 7, 2010).

52 Buckley v. Valeo, 424 U.S. 1, 424 U.S. 1, 67-68 (1976).

53 McConnell v. FEC, 540 U.S. 93, 201 (2003).

54 Citizens United v. FEC, 130 S.Ct. 876, 914 (2010).

55 514 U.S. 334 (1995).

56 *Id.* at 349-351.

57 *See*, *e.g.*, *Shrink Mo. Gov't PAC v. Maupin*, 892 F. Supp. 1246 (E.D. Mo. 1995), *aff'd* , 71 F.3d 1422 (8th Cir. 1995); *Yes for Life PAC v. Webster*, 74 F. Supp.2d 37 (D. Me. 1999); *Stewart v. Taylor*, 953 F. Supp. 1047 (S.D. Ind. 1997); *West Virginians for Life*, *Inc. v. Smith*, 919 F. Supp. 954 (S.D. W. Va. 1996); *State v. Moses*, 655 So. 2d 779 (La. Ct. App. 1995).

58 *See*, *e.g.*, Op. Del. Att'y Gen. No. 95-FBO1 (Sept. 29, 1995); Op. Mich. Att'y Gen. No. 6895 (Apr. 8, 1996); Op. Minn. Att'y Gen. No. 82t (Aug. 27, 1997); Op. Neb. Att'y Gen. No. 95040 (May 16, 1995); Op. Neb. Att'y Gen. No. 95039 (May 15, 1995) Op. N.M. Att'y Gen. No. 97-01 (Jan. 3, 1997); Op. Tenn. Att'y Gen. No. 95-090 (Aug. 29, 1995); Op. Tex. Att'y Gen. No. JC-0243 (June 29, 2000).

Intellectual Property

Impediments to Innovation: Implications of National Health Care Legislation for the Intellectual Property Community

*By David Applegate and Arthur Gollwitzer III**

The move toward a national health care plan in the United States has taken three major steps: passage of the Social Security Act under President Franklin D. Roosevelt in 1935;[1] passage of Medicare and Medicaid as amendments to the Social Security Act under President Lyndon B. Johnson in 1965;[2] and passage of the "Patient Protection and Affordable Care Act" under President Barack H. Obama in 2010. Although contemporaneous litigation may stop or slow its implementation,[3] and implementing regulations have not yet been drawn up or been published, it is safe to say that any legislation that regulates an estimated one-sixth of the national economy—and a segment that is particularly sensitive to and dependent upon innovation—will necessarily affect innovation and intellectual property rights.[4] The general merits (or, indeed, the constitutionality) of a national health care scheme are not the focus of this paper. Instead, we offer observations about the likely effect of this recently-passed legislation on the most significant driver of American economic growth in the twenty-first century, innovation and corresponding intellectual property rights.

I. Brief Legislative History

On March 23, 2010, President Obama signed H.R. 3590, entitled the "Patient Protection and Affordable Care Act," into law as P.L. 111-148. That bill had passed the Senate on December 24, 2009 by a vote of sixty to thirty-nine and the House on March 21, 2010 by a vote of 219 to 212. Immediately after voting on H.R. 3590, the House also passed H.R. 4872, entitled the "Health Care and Education Reconciliation Act of 2010," by a vote of 220-211, and President Obama signed it into law on March 30, 2010 as P.L. 111-152.[5] The analysis below focuses primarily on H.R. 3590, enacted as P.L. 111-148, with amendments by H.R. 4872, enacted as P.L. 111-152, as noted.

II. Overview of the "Patient Protection and Affordable Care Act"

The PPACA is divided into ten titles that regulate multiple industries, each of which depend heavily on science, technology, and innovation. Title I includes new statutes governing the health insurance industry, such as prohibiting certain coverage limits, extending dependent coverage, standardizing language and forms, and prohibiting preexisting condition exclusions; addresses costs; and attempts to achieve universal health care coverage by creating state insurance exchanges, providing tax credits, and requiring individuals to obtain health insurance or to pay a fine enforceable by the Internal Revenue Service. Title II amends existing government-run programs such as Medicaid, the Children's Health Insurance Program (also known as "CHIPs"), and the Medicaid prescription drug program. Title III attempts to address the quality and efficiency of health care. Title IV attempts to address chronic disease and overall public health, and Title V addresses the health care workforce.

Title VI addresses the "transparency and integrity" of the Act, Title VII addresses access to innovative medical technologies such as biologic drugs, and Title VIII addresses community living assistance. Title IX addresses funding for the Act. Finally, Title X contains a variety of amendments to the above sections based on the "Manager's Amendment" to H.R. 3590 added shortly before the Senate's December 24, 2009 vote. Of greatest interest here are Titles VII, II, and IX, although Titles III and VI also deserve a look.

III. PPACA Provisions Impacting Intellectual Property

A. Title VII

Title VII contains the provisions most obviously impacting innovation and intellectual property. Subtitle A of the Act, entitled the "Biologics Price Competition and Innovation Act of 2009,"[6] addresses biologic drugs—those made from living cells—and provides an abbreviated approval process for follow-on biologics similar to the Hatch-Waxman procedures for conventional drugs. Specifically, Section 7002 provides twelve years of exclusivity for the inventors of biologic drugs while providing an expedited pathway to approval for follow-on drug makers.[7] This legislation accelerates the application process for follow-on biologics and regulates certain kinds of patent litigation.

1. Biosimilar Application Process

Title VII defines a "biologic drug" as "biosimilar" to a branded company's biologic drug ("reference product") if it is (a) "highly similar" to the reference product (b) with no clinically meaningful differences in terms of safety, purity, and potency.[8] A "biological product" is "interchangeable" with the reference product if: (1) the biological product is determined to be "biosimilar" and (2) the biological product meets safety and efficacy standards compared to the reference product.[9]

Assuming the applicant thinks it meets one of these standards—to be defined later, in rules and regulations promulgated and codified in the Federal Register—an applicant must wait at least four years after the FDA first approves the reference product to file its biosimilar application, which the FDA then has eight to eight and a half years to approve. (The FDA may not approve the biosimilar application until at least twelve years after its first approval of the reference product, and may extend the term by six months if the FDA requests,

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and the brand company completes, certain pediatric clinical studies.)[10]

The FDA will then reward the first biosimilar applicant to establish interchangeability with the reference product with marketing exclusivity for a period ranging from twelve months after its first commercial marketing to eighteen months after approval (unless that applicant is involved in ongoing patent litigation), based on the earlier of:

• one year after first commercial marketing of first interchangeable biological product;

• eighteen months after approval, if no patent litigation had been instituted against the first interchangeable biological product,

• eighteen months after a final court decision of all patents in suit or dismissal with or without prejudice on litigation over the first interchangeable biological product; or

• forty-two months after approval if there is still ongoing patent litigation on the first interchangeable biological product.[11]

2. Biosimilar Patent Litigation

Before a biosimilar applicant and the brand company can pursue patent litigation, the parties must first exchange information such as the biosimilar application, manufacturing information, lists of potentially infringed patents, and arguments regarding infringement, validity, and enforceability. The parties must then follow detailed negotiation procedures during which the applicant decides the total number of patents that can be litigated. There is no automatic stay of FDA approval during any ensuing litigation. And failure to follow these procedures, such as failing to provide potentially confidential information, will have significant consequences, such as barring the brand company from seeking an injunction before the applicant commercializes its follow-on product.[12]

3. 340B program discounted drugs

Title VII of the Act also requires the General Accounting Office to report within eighteen months regarding the scope of section 340B of the Public Health Service Act, 42 U.S.C. § 256(b), known as the "340B Program."[13] Under the 340B Program, certain entities may purchase drugs at a discount from a federal list. The GAO report must address whether the 340B program "should be expanded since it is anticipated that the 47,000,000 individuals who are uninsured as of the date of enactment of this Act will have health care coverage once this Act is implemented."[14] Any expansion of the 340B Program—that is, expanding either the number of entities allowed to purchase discount drugs (or the number of drugs available at discount prices), or decreasing the discount price for available drugs—will necessarily reduce payments to drug makers.

B. Title II

Title II will expand the scope of Medicaid rebates for prescription drugs.[15] Title II is therefore likely to reduce the total revenue available to drug makers available for future research and development. Because U.S. drug manufacturers implicitly subsidize the health care systems of other nations by virtue of being the world's leading innovators, patients in Europe, Canada, and Japan have in the past been able to benefit from new drugs developed by American drug companies.[16] By equilibrating the cost of such subsidies, the Act will reduce the resources and incentive of drug companies to innovate at the pace seen over the last century. Ultimately, patients are likely to suffer more—and die earlier—as new treatments and cures are delayed or left undiscovered.

C. Title IX

Title IX's revenue provisions include taxes on branded pharmaceutical and medical device manufacturers and importers. In particular, Section 9008 of the Act, as amended, allocates an escalating multi-billion dollar annual tax among branded drug manufacturers and importers based on the absolute amount of their "branded prescription drug sales" to certain government programs[17] and their adjusted market share,[18] and Section 9009 imposes a 2.3% excise tax on medical device makers or importers.[19] The amount of the fee is based on the percentage that a specified percentage of the entity's branded prescription drug sales "taken into account" during the preceding calendar year bears to the "aggregate branded prescription drug sales" of all covered entities "taken into account" during the preceding calendar year, applied to an amount that varies from year to year.[20]

Basic economics teaches that taxing something (*i.e.*, raising its price) is likely to yield less of it, while subsidizing something (*i.e.*, reducing its price) creates demand for more. Although Section 9008 excludes the amount of a covered entity's sales in the private marketplace from the amount of "branded prescription drug sales" used in determining the amount of the fee, it will still affect overall profitability and incentives, in at least two ways.

The first order effects on both the pharmaceutical and the medical device industries will be to increase the price (cost) of their products, to leave fewer resources for research and development, and thereby to reduce the incentive of some companies in the industry to stay in business at all. Because of the disparate effective rates of the health care excise tax on pharmaceutical companies, the second order effect of these provisions on the pharmaceutical industry is more problematic, and at this stage difficult to quantify.

For example, the specified percentage of sales to government programs on which the excise tax is based varies with the amount of branded prescription drug sales the entity makes. For covered pharmaceutical entities with not more than $5 million in aggregate branded prescription drug sales during the calendar year that percentage is zero; for those with more than $5 million but not more than $125 million in such aggregate sales it is ten percent; for those with more than $125 million but not more than $225 million in such aggregate sales it is forty percent; for those with more than $225 million but not more than $400 million in such aggregate sales it is seventy-five percent; and for those with more than $400 million in such aggregate sales it is one hundred percent.[21]

To understand the second order effects of this approach, consider that in 2009 the total size of the U.S. pharmaceutical

market was an estimated $315-321 billion, with thirty active pharmaceutical companies, including Pfizer, GlaxoSmithKline, Johnson & Johnson, and Merck.[22] Thus, we could say that the "average" annual revenues of these companies, if apportioned equally, would be approximately $10.65 billion. Yet unless these revenues are evenly distributed, or unless all participants are above the $400 million annual sales threshold for branded prescription drugs, then the annual excise tax will work to the advantage of some and to the disadvantage of others.

Imagine, for example, that the entire U.S. pharmaceutical industry has $2.5 billion in covered "branded prescription drug sales" to the specified government programs in 2011, exactly equal to the initial aggregate amount of the excise tax. (This would be less than eight-tenths of one percent of the total pharmaceutical market for that year.) Imagine further that the distribution of such sales to the specified government programs is unequal, such that Merck has $401 million in branded prescription drug sales to government medical programs in 2011 and each of the remaining twenty-nine competitors has an equal share of the balance, or $72.38 million each.

Because Merck's covered branded prescription drug sales in this example would exceed $400 million, Section 9008(b) would require Merck to take one hundred percent of its covered sales into account for purposes of the excise tax. Because their covered sales would be less than $125 million, each of its twenty-nine competitors would have to take only ten percent of its covered sales into account. Thus, for excise tax purposes, Merck would account for $401 million in covered sales, and each other market participant would account for $7.238 million (ten percent of $72.38 million). Accordingly, although total covered sales to the specified government agencies would be $2.5 billion, the amount of sales taken into account for purposes of the excise tax would be only $610.9 million (Merck's $401 million plus the other twenty-nine competitors' aggregate $209.9 million).

Merck's hypothetical share of the $2.5 billion excise tax would therefore be roughly 65.64% of the total industry tax ($401 million/$610.9 million), notwithstanding that its share of the total branded sales to the specified government agencies would be only about sixteen percent ($401 million/$2.5 billion). Conversely, Merck's twenty-nine competitors would pay in the aggregate only 34.36% of the excise tax—or about 1.18% each—even though their aggregate share of the total branded sales to the government would be about eighty-four percent ($2.099 billion/$2.5 billion)—or about 2.9% each. In other words, Merck's effective tax rate on "branded prescription drug sales" would be more than eight times that of its competitors, because Merck would be paying at four times its proportionate share of the market and the competitors at less than one-half.

In this example, what would these numbers mean for the bottom line? They would mean that Merck's 65.64% share of that year's $2.5 billion excise tax is $1.64 billion. Because we have assumed, in this example, that total pharmaceutical industry sales (not restricted to "covered" sales to government agencies) are evenly distributed among the industry's twenty-nine participants, or approximately $10.65 billion each, Merck's revenues for the year net of the excise tax are reduced to $9.01 billion ($10.65 billion – 1.64 billion). Each of its competitors, however, would pay "only" about $29,619,950 ([$2.5 billion – $1.64 billion] / 29) in excise tax for the year, so their revenues for the year net of the excise tax would be approximately $10.62 billion each ($10.65 billion minus 29.62 million).

The net effect in this example, then, would be that total covered sales of branded prescription drugs to government agencies that constitute less than eight tenths of one percent of the total pharmaceutical market for brand name drugs that year would put one competitor at a $1.61 billion disadvantage—roughly fifteen percent of its total revenues—relative to its competitors. Because the excise tax is not deductible for income tax purposes, this difference would go straight to the bottom line.

In sum, a very small share of the total market that is disproportionately large in relation to "branded prescription drug sales" could have a dramatic effect on the bottom line of the pharmaceutical company that dominates the "branded prescription drug sales" market. Participants in this particular market would therefore have an economic incentive either to minimize their sales to the "specified government programs"—namely Medicare, Medicaid, TRICARE, and certain Veterans and Defense Department programs—or to form cartels to ensure that their relative participation were roughly equal.

The exact effects of Section 9008's excise tax will depend upon total "branded prescription drug" sales, their distribution among the companies in the market, and the aggregate amount of the tax each year. But if the federal income tax system is any guide, this sort of unequal treatment will divert otherwise productive resources to the relatively unproductive, paperwork-heavy tax avoidance industry instead. Tax lawyers and accountants thus may benefit at the expense of innovation in the health care industry.

D. Title III

Title III of the Act empowers the Secretary of the Department of Health and Human Services to establish a national strategy "to improve the delivery of health care services, patient health care outcomes, and population health."[23] This provision does not appear to extend as far as the "comparative effectiveness research center" proposed in earlier health care reform bills. Nevertheless, the Secretary is empowered to work with federal and state agencies to deliver health care in line with a national strategy developed under this provision rather than allowing market forces alone to set health care priorities. Even if the national strategy does not literally impact the private sector, the federal government will be the single largest consumer of health care services. The federal government's decisions thus will dictate the supply of treatments and innovations available to everyone.

E. Title VI

Similarly, Title VI empowers the Social Security Administration to establish the "Patient-Centered Outcomes Research Institute."[24] PCORI is reputedly not a government agency and is being created for the following purposes:

> [to] assist patients, clinicians, purchasers, and policy-makers in making informed health decisions by advancing

the quality and relevance of evidence concerning the manner in which diseases, disorders, and other health conditions can effectively and appropriately be prevented, diagnosed, treated, monitored, and managed through research and evidence synthesis that considers variations in patient subpopulations, and the dissemination of research findings with respect to the relative health outcomes, clinical effectiveness, and appropriateness of the medical treatments, services, and items described in subsection (a)(2)(B).[25]

IV. Conclusion

At bottom, the "Patient Protection and Affordable Care Act" both explicitly and implicitly impacts innovation and intellectual property rights, in some ways that are difficult or impossible to predict. Directly, the Act imposes a complicated regulatory scheme, details yet to be provided, concerning intellectual property protection of biologic drugs. Indirectly, the Act takes resources of drug companies and medical device makers and importers that otherwise might fund research and development or directly lower product costs. It remains to be seen, in other words, whether the recently-passed national health care legislation will violate the first and oldest rule in medicine: first, do no harm.

Endnotes

1 Social Security Act, ch. 531, 49 Stat. 620 (now codified at 42 U.S.C. ch.7).

2 Social Security Amendments of 1965, Pub. L. No. 89-97, 42 U.S.C. ch. 7, subch. XVIII, §§ 1395 *et seq.*

3 For a by-no-means exhaustive complaint against the constitutionality of PPACA, see the complaint in *State of Florida v. U. S. Dept. of Health & Human Services*, Case 3:10-cv-00091-RV-EMT, (N.D. Fla. March 23, 2010), which argues that the Act violates the Commerce Clause and the Taxing and Spending Clause (Art. I, Sec. 8), the prohibition against unapportioned capitation or direct taxes (Art. I, Secs, 2, 9), the sovereign rights of states to a republican form of government (Art. IV, Sec. 4), and the Tenth Amendment. Other arguments advanced elsewhere include objections under the First Amendment's Free Exercise Clause and the Fifth Amendment's Takings Clause. *See* Peter Urbanowicz & Dennis G. Smith, Federalist Soc'y for Law & Pub. Policy Studies, Constitutional Implications of an "Individual Mandate" in Health Care Reform 5 (2009), *available at* http://www.fed-soc.org/doclib/20090710_Individual_Mandates.pdf.

4 *See* H.R. 3590, 111th Cong., § 1501(a)(2) (2010) (enacted), spelling out findings regarding the national economic importance of health care and stating that spending on health insurance and health care services constituted 17.6% of the economy in 2019. For a statement that national health care is likely to retard innovation, see the remarks of former Clinton Administration Secretary of Labor Robert Reich given at the University of California at Berkeley on September 26, 2007, available at http://www.youtube.com/watch?v=IT7Y0TOBuG4.

5 H.R. 4872 was designed to appease House members upset about certain aspects of the Senate bill which the press and political critics have dubbed the "Louisiana Purchase," the "Cornhusker Kickback," "Gator Aid," "Handout Montana," "the U Con," and the "Bayh Off," collectively referred to as "Cash for Cloture." *See, e.g.*, Dana Milbank, On Health-Care Bill, Democratic Senators Are in States of Denial, Wash. Post, Dec. 22, 2009, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2009/12/21/AR2009122102861.html?hpid=topnews.

6 H.R. 3590, § 7001 *et seq.*

7 *Id.* § 7002(k) (7).

8 *Id.* § 7002(k) (2) (A) (i) (I).

9 *Id.* § 7002(k) (4).

10 *Id.* § 7002(k) (7).

11 *Id.* § 7002(k) (6).

12 *Id.* § 7002(l).

13 *Id.* § 7103.

14 *Id.* § 7103(b) (1).

15 *Id.* § 2501.

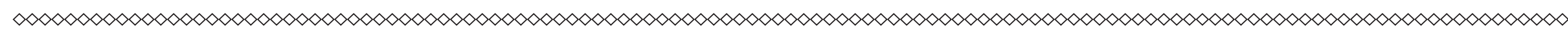
16 The United States has the largest pharmaceutical industry in the world, with calendar year 2007 revenues totaling approximately $315 billion. The combination of market competition, patent protection of new medicines, an aging population, the emergence of bio-pharmaceutical technology, and fierce global competition have led to increasing research and development since the year 2000. This includes a 3.16% annual increase even during the global financial crisis year of 2008, when U.S. pharmaceutical R & D expenditures totaled a reported $65.2 billion. Approximately 2,900 drugs are currently undergoing research and testing in the United States, including approximately 750 for cancer treatment, 312 for heart diseases, 150 for diabetes, 109 for AIDS, and ninety-one drugs for Alzheimer's disease and related dementia. *See* US Pharmaceutical Industry Report, 2008-2009 (2009) (summary available at http://www.reportlinker.com/p0118600/US-Pharmaceutical-Industry-Report-2008-2009.html).

17 H.R. 3590, § 9008 defines a "covered entity" as "any manufacturer or importer with gross receipts from branded prescription drug sales," H.R. 3590, § 9008(d), 111th Cong. (2010) (enacted), and "branded prescription drug sales" as sales of "branded prescription drugs" to "any specified government program" or "pursuant to coverage under any such program." *Id.* § 9008(e) (1). "Specified government program" means Medicare Parts B and D; Medicaid; Department of Veterans Affairs and Department of Defense programs that procure "branded prescription drugs"; and the TRICARE retail pharmacy program, formerly part of what was known as the Civilian Health and Medical Program of the Uniformed Services (CHAMPUS), a health care program of the United States Department of Defense Military Health System, that provides civilian health benefits for military personnel, military retirees, and their dependents, and some members of the reserves. *Id.* § 9008(e) (4).

18 H.R. 3590, § 9008, requires each "covered entity" in the "business of manufacturing or importing branded prescription drugs" to pay a "fee" to the Secretary of the Treasury no later than September 30 each year. *Id.* § 9008(a). For Internal Revenue Service purposes, the "fee" is treated as an "excise tax" with respect to which only civil actions for refunds under Subtitle F of the Internal Revenue Code apply, so that such fees are not deductible. *Id.* § 9008(f).

19 Originally, H.R. 3590, § 9009 imposed a fee on medical device makers or importers calculated in much the same way as that of § 9008(b), but based on an aggregate $2 billion fee, "gross receipts" rather than "sales taken into account," and with only three size classes of "covered entities": those with aggregate "gross receipts" of not more than $5 million (zero percent); those with aggregate "gross receipts" of more than $5 million but not more than $25 million (fifty percent); and those with aggregate "gross receipts" of more than $25 million (one hundred percent). H.R. 3590, § 9009(b), 111th Cong. (2010) (enacted). Before Congress even passed the bill, § 10904 amended § 9009(b) to increase the aggregate amount of the "fee" to $ 3 billion after 2017. H.R. 3590, § 10904(a), 111th Cong. (2010) (enacted). That is the way matters stood for exactly one week following President Obama's signing H.R. 3590 into law. On March 30, 2010, however, H.R. 4872 repealed § 9009 of H.R. 3590, as amended, retroactively effective to its enactment date, and replaced it with a 2.3% tax on the sales price of "any taxable medical device sold by the manufacturer, producer, or importer." H.R. 4872, § 1405(d), 111th Cong. (2010) (enacted).

20 H.R. 4872, § 1404(a) (2), 111th Cong. (2010) (enacted). As discussed later in this article, the specified percentage of sales taken into account for covered entities with not more than $5 million in aggregate branded prescription drug sales during the calendar year is zero; for those with more than $5 million but not more than $125 million in such aggregate sales it is ten percent; for those with more than $125 million but not more than $225 million in such aggregate sales it is forty percent; for those with more than $225 million but not more than $400 million in such aggregate sales



it is seventy-five percent; and for those with more than $400 million in such aggregate sales it is one hundred percent. H.R. 3590, § 9008(b) (2), 111th Cong. (2010) (enacted). Originally, the aggregate fee imposed on the pharmaceutical industry was to be $2.3 billion. *Id.* § 9008(b) (1). Under the reconciliation bill, however, the aggregate industry fee begins at $2.5 billion with calendar year 2011 and increases to $2.8 billion in 2012 and $3 billion in 2014. There it remains until after the 2016 presidential election year, when it increases to $4 billion in 2017 and $4.1 billion in 2018. In 2019 and thereafter, it returns to its 2012 level of $2.8 billion per year. H.R. 4872, § 1404(a) (2) (b), 111th Cong. (2010) (enacted).

21 H.R. 3590, § 9008(b) (2), 111th Cong. (2010) (enacted).

22 *See supra* note 22.

23 H.R. 3590, § 3011, 111th Cong. (2010) (enacted).

24 *Id.* § 6301.

25 *Id.*

Trademark, Copyright, and the Internet: Time to Return Balance to Civil Litigation

*By Ronald D. Coleman**

The law and business of intellectual property are in upheaval today. Essentially, the concepts that underlay the conceptual, statutory, and judicial schemas that govern each of patent, trademark and copyright are rapidly being overwhelmed by technologies that could not have been foreseen even half a generation ago, much less when the roots of the legal doctrines surrounding each of these types of IP protection and the economic models on which they are premised took hold. The purpose of this essay is to consider one of these areas in particular, namely trademark, and to focus in particular on how developments in copyright arising from the new digital media have affected this area of law. I argue that a series of legal developments has turned an area of law historically meant to shield consumers from non-authentic merchandise and preserve entrepreneurial investments in "brands" into a weapon to stifle competition and protect entrenched, inefficient business models. These developments have taken trademark law far beyond the language of the Lanham Act, the modern trademark statute, into a world where judges have not feared to tread and "make policy" affecting broad areas of economic activity to Congress's silent assent.

It is impossible to consider the last decade's developments in trademark without understanding what is going on in copyright. Copyright law is trademark's "soft IP" cousin and a frequent source of judicial "borrowing" as new issues arise in the courts and statutes provide little or no guidance. Copyright is the area of intellectual property that most directly implicates constitutional issues of free speech. Congress has also been far more active in amending the Copyright Act and making affirmative policy decisions, arguably for political reasons (i.e., in response to lobbying), than it has with respect to trademark. Passage of the Digital Millennium Copyright Act ("DMCA"), for example, was not accompanied or followed by a companion set of "digital" reforms in trademark. The need to do so was not necessarily obvious at the time, given the policy goals the DMCA was meant to address, which are beyond the scope of this essay. Yet courts, conditioned by generations of mainly innocuous copyright/trademark "borrowing," have increasingly begun to look to the DMCA for answers to trademark questions that Congress has not given on its own or where Congress's silence may more appropriately be weighed as a policy choice—i.e., a choice not to extend certain protections given to copyright owners under the DMCA—rather than a broad statement of congressional intent respecting IP.

As a matter of first principles, copyright protects the tangible expression of creativity. The copyright laws are widely understood as providing an incentive for the investment of creative power and resources into such works by assuring those who make such investments with a high degree of legal control over their fruits. This neat conception, however, is at risk of nearly complete obsolescence. This threat to copyright lies not so much in the claims of a developing critical literature seeking to undermine this theoretical construct at its core as in changes no less radical in how creative works are "created" and, to a far greater degree, how they are distributed both legally and otherwise.

No one needs to be reminded that media for communication, expression, and performance are now ubiquitous. The financial value of many kinds of creative content once constituting predictable revenue streams, even without reference to infringement of copyright, has plummeted. The disappearance of entry costs for publication and distribution of creative works in digital form, and the relatively low cost for producing many such works—typified by online publications such as blogs and other online sources of news and information—threaten traditional business models. Industries such as popular music production and promotion and traditional news media are most vulnerable to these changes. The second of these business sectors may not even last long enough to share in either the development or benefits of any innovative approach to legal rules in copyright.

Moreover, there is growing "demand side" hostility to copyright enforcement. Digital media's power to deliver essentially perfect performances or packages of creative works at marginally trivial cost is in a battle with the concomitant "leakage" of that power to consumers, who increasingly and with or without the aid of middlemen acquire such works for themselves without compensation to their creators or owners. Technological fingers in the digital dike—vaunted "new and improved" forms of DRM, or Digital Rights Management—are proving increasingly ineffectual in the face of technological countermeasures and increasing cultural resistance to voluntary compliance. Copyright stakeholders have been reduced to the use of bulk litigation campaigns to "tangibly fix" a legal regime that is less amenable to management than ever, whether by technical or political means. Yet the series of mass litigation "campaigns" undertaken by stakeholders in the music and film industries against college students, children, and grannies involved in illegal downloading of music and movies has resulted in varying degrees of legal "success," and there is an increasing lack of public support for such efforts, notwithstanding the seeming clarity of legal rules that apply to such activities.

And innovation there must be. Notwithstanding their ideological or other predispositions on the matter, the aforementioned developments suggest to most people working in the field or closely observing this battle that the traditional stakeholders—copyright owners—are very likely going to lose some significant portion of what they right now consider

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inviolably "theirs." The "supply" and "demand" tug of war is, perhaps, no better typified than in the mounting controversy over phenomenal infringement litigation damage awards, notionally authorized by broad statutory language but bearing no rational relation to traditional notions of "damages," defined as compensation for a harm done by a tortfeasor. And it is in this area that we can begin to understand the direct effect of developments in copyright on the increasingly important area of trademark law.

Under the Copyright Act, statutory damages are, contrary to popular belief, not intended to be a windfall for the lucky holder of an infringed copyright. Rather, they are meant to effect just compensation that bears a reasonable relationship to compensatory damages that may be difficult or impossible to prove, albeit with an added consideration—added, but not disproportionately dominant—of the need to deter future infringement.

In determining the measure of statutory damages to be awarded, courts typically consider the following factors:

> expenses saved and profits gained by the defendants in connection with the infringements; revenues lost by plaintiffs as a result of defendants' conduct; and the infringer's state of mind, that is, whether willful, knowing, or merely innocent. Moreover, the court should consider the purposes of the Copyright Act, including restitution to prevent unjust enrichment, reparation of injury, and deterrence of further wrongful conduct by the defendants and others.[1]

"'Willful' refers to conduct that occurs with knowledge that the defendant's conduct constitutes copyright infringement.' . . . The determination of willfulness is a question of fact reserved for the jury."[2]

This is not the formula for a blitzkrieg-like achievement of an easy liability judgment and the maximum grant of statutory damages copyright infringement plaintiffs often envision, or with which their lawyers threaten trembling recipients of their cease and desist demands. Nor does a finding of willfulness mean that a plaintiff is entitled to the maximum statutory damage award, even in the face of a defendant's default. A similar treatment of the matter can be seen in a case from the Southern District of New York, even in the face of a defendant's default. The case involved pirated pay-per-view broadcasts, but the court was unwilling to bring down the wrath of heaven in the form of statutory damages when considering the reality of the economic picture at bar, even in the face of that mortal sin of civil litigation, the dreaded default:

> Some courts . . . have concluded that a defendant's default itself could be viewed as evidence of willfulness [or make similar inferences based on profit motive to infringe]. . . .
>
> [But] the plaintiff has failed to offer credible evidence that an enhanced damages award in the exorbitant amount of $100,000, or something in that range, is necessary to accomplish the goals of the statute, i.e., the use of enhanced damages to alter the economic expectations of prospective violators. Regardless, even in the case of a default judgment, a plaintiff must do more than gesture at an inference to support its request for enhanced damages. . . .
>
> In addition, **the value of deterrence must be balanced against the inequity of imposing heavy financial burdens on small businesses.** The sting of an enhanced award should not be greater than deterrence requires and fairness allows. Thus, I award Joe Hand an additional $1,500 in enhanced damages from each defendant. This enhancement is not so large that it will spell financial ruin for the small businesses involved, especially if, as I suggest, Joe Hand allows installment payments over the course of a year or more, but it is large enough to raise the dollar amount of the penalty above the cost of obtaining a commercial license, and, for businesses of this size, should be a sufficient deterrent to avoid future violations.[3]

In so ruling the District Court cited an even earlier case, 1980's *Doehrer v. Caldwell*,[4] which taught as follows:

> A mechanical application of the statutory damage provision of the Copyright Act leads to absurd results. While Section 504's compensatory purpose should not be minimized, its deterrent provisions should not be converted into a windfall where, as a practical matter, the plaintiff has suffered only nominal damages. It is clear from the legislative history of the Copyright Revision Act of 1976 that Section 504 was designed, in part, "to provide the courts with reasonable latitude to adjust recovery to the circumstances of the case, thus avoiding some of the artificial or overly technical awards resulting from the language of the existing statute." S. Rep. No. 94-473, 94th Cong., 2d Sess., reprinted in CCH Copyright Revision Act of 1976 P2042. . . .

In fact, statutory damages are **not** penalties. The purpose of statutory damages is to permit a wronged plaintiff to recover where there is insufficient proof of actual damages or profits. Substantial damages are, the courts typically hold, only be awarded for substantial injury.

Yet something—it is not obvious what this something is—within the judicial system keeps fighting against these fundamentally fair principles, and doing so with increasing vigor. Only months ago a jury awarded $2 million—little more collectible than "all the money in the world"— to the Lords of Music for what was indeed knowing copyright infringement of two dozen songs. As one Internet commentator, blogger Stan Schroeder, wrote:

> In one of the most ridiculous verdicts I've seen, the jury decided that Jammie Thomas-Rasset, the first woman who was charged with copyright infringement and offered to settle but decided to fight the RIAA, is guilty and owes the recording industry 1.92 million dollars, or $80,000 per song.
>
> As we mentioned in our original article, Jammie's case was full of holes, and she probably would have done better if she had just settled with the RIAA. But what's striking here is the amount of money awarded to the recording industry for infringing the copyright for just one song.
>
> It reminds me of a recent Penny Arcade comic which mocks Microsoft's Zune Pass, which offers unlimited

> selection of music for 15 dollars per month; since time never ends, this technically amounts to infinity dollars. Since the music is DRMed, if you ever stop paying, you lose all your music.
>
> It's just a joke, but it makes a good point. How much is one song worth to you? How much is it worth to the author? How much is it worth to the recording industry? You can push arguments to favor each side, and ultimately you can always claim that a song never fully loses its value and it can therefore be set to an arbitrary, insanely high amount of money.
>
> The problem with this approach is that it results in cases like the one against Jammie Thomas-Rasset, who now has (there are indications that the RIAA is still willing to settle with a much lower amount of money, but it's irrelevant; what's important is the principle of the matter) to pay 1.92 million dollars for infringing the copyright of 24 songs.[5]

There are obvious problems with such an outcome, including a two-pronged constitutional one—are such awards unconstitutionally excessive, and is there a different standard on that question when it comes to statutory damages? There is as well the policy question, beyond the scope of this article, raised by a Congress that continually extends the term of copyright protection.[6]

Of special interest to those practicing in the trenches of IP litigation is what can fairly be described as another, increasingly-significant distortion of the rights-allocations-by-litigation process, and one resulting from an explicit congressional mandate whose evolution in judicial hands nonetheless does not seem to have been entirely anticipated. These are the fee-shifting provisions of the Copyright Act, which make the costs of defending an infringement claim out of reach for virtually all individual defendants, and the risks of losing such a case "even a little" prohibitive, regardless of the merits. Section 505 of the Copyright Act provides that a court may award "the prevailing party" reasonable attorneys' fees as part of its "costs."[7] "Under the Copyright Act, the prevailing party is one who succeeds on a significant issue in the litigation that achieves some of the benefits the party sought in bringing suit."[8] Accordingly, at least in theory, prevailing defendants as well as prevailing plaintiffs are eligible for such an award, and the standards for evaluating whether an award is proper are the same regardless of which party prevails.[9]

Such rulings are few and far between, however; it may take very little for a copyright plaintiff to "prevail," meaning to show the existence of liability, even in the complete absence of the traditional *sine qua non* of a tort claim—harm or damages. Thus, for example, in *Pure Grace, Inc. v. Furlong*, the court granted "costs" to plaintiff as the prevailing party even though it was entitled to no damages and received only injunctive relief because the issuance of an injunction in that case afforded the plaintiff a substantial portion of the relief it sought.[10] Congress obviously intended to protect precisely those parties least likely to show actual damage, such as writers and artists, and who without a likely grant of attorneys' fees irrespective of financial harm could never afford to use the legal system to prevent or stop infringement of their works. And indeed, as a balance to the obvious potential for abuse in such a system, the Copyright Act, as stated before, provides for defendants to receive their "costs" if they in turn back a meritless copyright claim.

Such awards are, however, seldom granted. The bona fides of a copyright claim are easily established—again, notwithstanding that an otherwise valueless work, or one only "incidentally" protected by copyright but not in and of itself a traditional source of copyright protection (such as product labels), may be "infringed" in only the most attenuated manner and that the copyright claim in this case is merely a pretext for anticompetitive litigation.[11] Furthermore, a significant number of courts, including those bound by the rulings of the Ninth Circuit Court of Appeals—which handles a disproportionately high number of copyright cases—have held that under no circumstances can a defendant that successfully fends off a non-meritorious copyright infringement claim be awarded attorney's fees as "costs" of the "prevailing party" for purposes of the offer of judgment provisions of Fed. R. Civ. P. 68.[12]

Under such a schema, copyright owners are insulated from what are conceived to be the litigation-tempering properties of the American Rule. This applies even to starving artists and writers, once issue is joined: To the extent fee awards are collectible, copyright registrants have no incentive whatsoever to compromise on their litigation demands (especially in the Ninth Circuit) until a final order of liability and entitlement to fees is entered. (Their attorneys have even more "skewed" incentives.) The outcome is that copyright infringements, or alleged infringements, that result in little or no damage to the copyright holder and little or no obviously cognizable reduction in social welfare have the potential to become windfalls for claimants and their attorneys—with little or no concomitant disincentive to file non-meritorious, trivial, or pretextual claims. As William Patry, a leading authority on copyright, author of a major copyright treatise, and copyright counsel for Google, recently wrote:

> Copyright law has abandoned its reason for being: to encourage learning and the creation of new works. Instead, its principal functions now are to preserve existing failed business models, to suppress new business models and technologies, and to obtain, if possible, enormous windfall profits from activity that not only causes no harm, but which is beneficial to copyright owners."[13]

In light of these developments in copyright, what kind of tool, then, has trademark law become in modern business? IP lawyers and consultancies, including specialized firms offering advice and services in connection with IP and other "brand equity" valuation, management, and enforcement, ironically cannot urge the adoption of, or unilateral application of, copyright principles to trademark rights fast enough. Many thought leaders, corporate legal departments, and judicial officers are happy to cooperate, for while copyright enforcement's results have little to recommend them, and even though there is (other than in counterfeiting cases) virtually no fee-shifting in the Lanham Act, there is in the copyright jurisprudence at least the illusion of structure and predictability. This magnetic pull is under way despite the difference between the purposes

and nature of the two types of protection, the contrast in the statutory schemes governing them, and the distinctions between both the practical and doctrinal free speech concerns that affect them in different ways.

Many "IP enforcement" attorneys believe that while there is no shortage of bona fide infringement to occupy at least a large number of them, trademark law practice has, to a very large extent, descended to an anti-competitive methodology utilized by dominant market players not to prevent consumer confusion, as was its original rationale, but to reduce consumer choice and overall welfare by preventing competition. For them, the signal development enabling this "evolution" must be widespread acceptance, on extremely dubious authority, of the doctrine of "initial interest confusion" ("IIC") in trademark as a substitute for the traditional standard requiring that a finding of infringement be based on evidence of a "likelihood of confusion" between the plaintiff's trademark and the device, words, or other branding mechanism utilized by the defendant.

IIC is a species of law designed to deal with the "problem" that most cases of alleged trademark infringement on the Internet based on "consumer diversion" do not really involve any legally cognizable "likelihood of confusion"—the essence of trademark harm enshrined in the Lanham Act[14]—but still seem to some judges like something that should stop. The concept of IIC is that consumers searching for "Brand X" on Google may, by dint of keyword advertising or other techniques, find themselves on a website that "lures" them with text or other allusions to "Brand X," but really tries to sell them "Brand Y." The confusion ends instantly, but early in Internet history, at plaintiffs' urging, courts embraced what had been a quiescent theoretical replacement for actionable confusion and deemed it a basis for trademark infringement on the Internet. As Professor Eric Goldman has written:

> [A] defendant cannot mount an adequate defense against the initial interest confusion doctrine because the doctrine lacks any rigorous definition or normative support in the first place. The defense challenge is especially problematic where . . . a court improperly puts the burden on the defendant to disprove that consumers experienced initial interest confusion. Exactly what proof would satisfy the court here? I can't answer this and I bet the court couldn't either, and I can go further and assert that evidence to disprove initial interest confusion simply does not exist at all.[15]

Effectively, courts that rely on this doctrine confer the critical likelihood of confusion component of a trademark infringement claim to any party asserting trademark ownership. In turn, likelihood of confusion raises a legal presumption of irreparable harm.[16] This is then asserted to be adequate grounds for the granting of both preliminary and, typically, permanent injunctive relief—no questions asked.[17] Thus in IIC, the courts grant putative trademark owners all they need to destroy incipient competitors (not merely commercial, but ideological[18] or theological[19] as well) that may or may not actually be **infringing a trademark** as that concept had been understood for the generations "before IIC."

Deprived of traditional defenses that could disprove a likelihood of confusion, and facing plaintiffs who have been relieved of their burden of proving the same by submission of survey evidence or other competent proof, defendants accused of Internet-based trademark infringement seldom have much fight left in them. And while trademark defendants are seldom subjected to the additional pressure of fee-shifting, much less statutory damages, their prospects for any sort of compensation even after prevailing in a trademark infringement trial or summary judgment motion are essentially zero. Notwithstanding that the Lanham Act authorizes an award of fees to prevailing defendants in "exceptional cases,"[20] it is a commonplace among practitioners that such awards are unheard of.

While copyright has nothing like IIC, its widespread adoption still helps demonstrate copyright's influence over trademark law. IIC is hardly necessary in copyright infringement claims, where the analogous component of the cause of action is whether the work in question has been "copied"—rarely a difficult inquiry. But IIC makes trademark work almost exactly like copyright in that respect: Plaintiff has "intellectual property"; defendant utilized it "without authorization"; plaintiff is entitled to at least some relief. Thus, according to some, is intellectual property enforced and brand equity maintained.

This formula is thus ideally effectuated by the transmission of blunderbuss cease and desist demands; next is the filing, in a favorable venue, of an extensive multi-count complaint alleging copyright and trademark infringement of copyright, unfair competition, trademark dilution, and usually other torts including interference with prospective business relations. A new trend is claiming tortious interference with third-party contracts between the plaintiff and its distributors by means of the defendant's purchase, on the open market, of plaintiff's merchandise to sell online—constituting a "inducement" of a breach of a distributorship contract (known or unknown to defendant) prohibiting such sales.[21]

Few defendants can fund the motion practice for dismissal of impressive, fact-rich pleadings with reams of exhibits showing the plaintiff's portfolio of trademark registrations—the embodiment of its "brand equity." Prevailing on such a motion, in whole or in part, does not result in reimbursement of the expense incurred by defendant in doing so anyway. And even then, it is enough for the plaintiff if only two or three or six of a dozen claims "stay in the case"—it can begin the "discovery" process: the combing of tax filings for "infringers' profits" data, the interrogatories, and the depositions.

Even then, for plaintiffs, "losing" such a case, in the rare instance in which a defendant can last long enough to get to a final judgment, is routinely and publicly described as a "cost of doing business" and "reassurance" to others with investments in its brand equity—its brick-and-mortar distributors, its indirectly-price-controlled "authorized" retailers and even its old-line "competitors." More: a "loss" today is typically not dispositive regarding future torts committed tomorrow involving the same facts, or perhaps in a different judicial district. There is no limit to how this system of civil enforcement can be turned on competition because the law places no limit on it. Just as in copyright, in trademark the small matter of whether

the supposed victim of the tort in question has suffered or will suffer harm is lost—along with a great deal of justice.

The civil litigation system was not designed for the use of large companies to put small enterprises out of business, but it is perfectly suited for doing so. Copyright and trademark law, in tandem and with reference to each other, were meant to protect, respectively, creativity and reputation or consumer interests. They were crafted to apply to narrow bands of behavior affecting specifically identified bundles of rights. The enterprise of convincing a court to invoke them and restrain the behavior of others once required admissible and reasonably rigorous proof of infringement consistent with ancient Anglo-Saxon judicial norms. Today, however, trademark and copyright are methodologies of "IP enforcement," and even of censorship. Notwithstanding the existence, and even the growth, of real threats to intellectual property rights, especially in copyright, strategies for abusing IP claims to achieve entirely unrelated tactical goals are utilized routinely, formulaically, and often successfully.

The Internet has provided a post-industrial economy with once unimaginable vistas of entrepreneurial possibility. Yet the more central the Internet becomes to the economy, the more of a threat its relatively untamed nature is to companies with the most to lose to innovators. The problems described here do not require wholesale changes in the law to solve. But the interests of existent stakeholders to push in the other direction will only increase as "brand equity" and soft IP become more and more critical to the business models utilized in key sectors. The current regime of risk and benefit allocation will not protect Internet commerce's future.

Congress must level the playing field with respect to attorneys' fees in copyright; stop increasing the upper limits of statutory damages that have no effect on the most egregious infringers but do act as outsized levers of intimidation over highly vulnerable defendants whose activities may even be lawful; put teeth into the extant, but largely ignored, provisions for sanctions and attorneys' fees available to defendants that prevail in trademark claims; and reassert the classical likelihood of confusion standards for trademark infringement. Meanwhile, judges must also return to demanding rigorous proof and appropriately assigning litigation burdens in "IP" cases just as they do in other areas of law. Our Internet future may depend on it.

Endnotes

1 Walt Disney v. Video, 47, 972 F. Supp. 595, 603 (S.D. Fla. 1996) (citations omitted).

2 *Id*.

3 Joe Hand Promotions, Inc. v. Hernandez, 2004 U.S. Dist. LEXIS 12159 (S.D.N.Y. June 30, 2004) (some citations omitted; emphasis added) (citing Garden City Boxing Club, Inc. v. Ayisah, No. 02-CV-6673, 2004 U.S. Dist. LEXIS 7867, at *5 (S.D.N.Y. April 28, 2004) ("[P]laintiff must . . . substantiate a claim with evidence to prove the extent of damages.").

4 1980 U.S. Dist. LEXIS 10713 (N.D. Ill. 1980).

5 Posting of S. Schroeder to Mashable: The Social Media Guide blog, *Ever Downloaded a Copyrighted Song? You Owe Infinity Dollars*, http://mashable.com/2009/06/19/infinity-dollars/ (June 19, 2009).

6 Activist and attorney Gigi Sohn writes:

> Yesterday was the 10th anniversary of the enactment of the Sonny Bono Copyright Term Extension Act of 1998. That law extended copyright terms from 50 years after the life of an author and 70 years in the case of corporations, to 70 years beyond the life of an author and 95 years in the case of corporations. Named after Sonny Bono, the late Congressman best known for his musical and personal partnership with the performer Cher, the law has taken countless works out of the public domain, greatly weakening the wellspring of creativity and knowledge from which new creativity emerges.
>
> Unlike the DMCA, whose unintended consequences have been well documented, it is much harder to quantify the harms caused by the Sonny Bono Act. How can you measure the number of new works and new wealth that were not created because of the extended terms? Or the number of new orphan works created? But since it has been shown that about 98% of copyrighted works lose their value between year 55 and year 75 of protection, we know who has profited from the law—large, multinational media companies like Disney, Fox and NBC-Universal, who maintain a vise-like grip on works that should have belonged to the public years ago. Suffice it to say that the Sonny Bono Act was nothing more than corporate welfare for big copyright holders. Even a copyright industry sympathizer like Representative Howard Berman has admitted to me that in hindsight he believed that voting for the extension was a mistake.

Posting of Gigi Sohn to Public Knowledge Blog, *Reflections on the 10th Anniversary of the Sonny Bono Act*, http://www.publicknowledge.org/node/1830 (Oct. 29, 2008).

7 17 U.S.C. § 505.

8 Ory v. McDonald, 141 Fed. Appx. 581, 584 (9th Cir. 2005).

9 *See* Perfect 10, Inc. v. CCBill LLC, 488 F.3d 1102, 1120 (9th Cir. 2007).

10 2006 U.S. Dist. LEXIS 88080 (D. Or. 2006).

11 *See* S & L Vitamins, Inc. v. Australian Gold, Inc., 521 F. Supp. 2d 188, 214 (E.D.N.Y. 2007).

12 *See* Champion Produce, Inc. v. Ruby Robinson Co., 342 F.3d 1016 (9th Cir. 2003).

13 Posting of William Patry to Patry Copyright Blog, *End of the Blog*, http://williampatry.blogspot.com/2008/08/end-of-blog.html (August 1, 2008).

14 15 U.S.C. §1114, 1125.

15 Posting of E. Goldman to Technology & Marketing Law Blog, *Adwords Ad Creates Initial Interest Confusion*--Storus v. Aroa, http://blog.ericgoldman.org/archives/2008/03/adwords_ad_crea.htm (March 23, 2008).

16 *See* Lone Star Steakhouse & Saloon, Inc. v. Alpha of Virginia, Inc., 43 F.3d 922, 939 (4th Cir. 1995).

17 Planned Parenthood Fed. of America, Inc. v. Bucci, 1997 WL 133313, 42 U.S.P.Q.2d 1430 (S.D.N.Y. 1997), *aff'd*, 152 F.3d 920 (2d Cir. 1998).

18 *Id*.

19 Jews for Jesus v. Brodsky, 993 F. Supp. 282 (D.N.J.), *aff'd*, 159 F.3d 1351 (3d Cir. 1998).

20 15 U.S.C. § 1117(a).

21 *See* Australian Gold, Inc. v. Hatfield, 436 F.3d 1228 (10th Cir. 2006). *But see* Designer Skin, LLC v. S & L Vitamins, Inc., 560 F. Supp. 2d 811 (D. Ariz. 2008).

Wyeth v. Kappos: The United States Patent Office Is Forced to Change Course

*By John C. Freeman**

The United States Patent Office ("USPTO") was established in 1790 with the mission to determine whether an invention merited a patent. Such a patent conveys a monopoly to the owner of the patent that allows the owner to prevent others from making, using, offering to sell, or selling the invention in the United States. According to the U.S. Constitution, the monopoly has a finite period for enforcement.[1] In 1994, Congress decided to change the way the term was calculated from being measured from the date of grant of a patent to being measured from the date of filing of a patent application. Later, Congress recognized that laws were needed to address delays during examination of a patent application which could lead to the shortening of the term of the patent. As with most patent laws, the USPTO presented rules to address the laws regarding delays during examination. While most of the rules regarding delays were straightforward, there were several instances where the USPTO did not address the statutory changes through its rules. One such instance was exposed by the Court of Appeals for the Federal Circuit (CAFC), which held in the case *Wyeth v. Kappos* that the USPTO implemented rules regarding delay that were contrary to the intent of Congress' laws.

I. History of Determining Patent Term

A. Before June 7, 1995

Historically, the term of a U.S. patent has been a fixed number of years as measured from the date of grant of the patent. At the inception of the U.S. Patent Office in 1790, Congress adopted the English Statute of Monopolies, which allowed for patents to have a term of fourteen years or less.[2] This term was revised to seventeen years with the Patent Act of 1861 and continued with the passage of the Patent Act of 1952 until the adoption of a new standard in 1995.[3] One constant from 1790 to 1995 was that the actions of the USPTO never had an effect on the term of a patent since this period of time was measured from the date of grant.

B. From 1995 to Today

The calculation of a patent's term began to change drastically in 1994 with the adoption of an "Agreement on Trade-Related Aspects of Intellectual Property" ("TRIPS") by the United States during the "Uruguay Round" trade talks in accordance with the General Agreement on Tariffs and Trade (GATT). The TRIPS agreement included standards regarding various intellectual property rights. Regarding patents, Article 33 of the TRIPS agreement stated that "[t]he term of protection available shall not end before the expiration of a period of twenty years counted from the filing date."[4] Faced with Article 33's mandate along with opposition from certain Republicans in Congress, the Clinton Administration negotiated a compromise to adopt Article 33 wherein legislation passed establishing a two-prong approach. In one prong, any patent that was granted from an application pending as of June 7, 1995 would have a term equal to the greater of seventeen years from grant or twenty years from the filing of the application. The second prong regarded patents granted from a patent application filed on or after June 8, 1995, wherein such patents would have a term of twenty years from the filing.[5] The end result was that the longer time taken to prosecute a patent application filed on or after June 8, 1995 would result in shortening the term of a patent. In essence, actions taken by both applicants of patent applications and the USPTO could result in the lessening of patent term.

II. Regulation of Term by Congress

A. Regulation of Inventions Subject to Regulatory Review

Congress has not favored any action by a regulatory agency effectively shortening the term of a patent. This is evidenced by Congress' passage of various statutes that provide additional term to a patent to compensate for delays in enforcing the patent due to a federal review of such inventions as compositions[6] and new drug products.[7] Laws, such as 35 U.S.C. §§ 155, 155A and 156, provide for the granting of extra patent term when regulatory review of certain inventions cause a shortening of the term. Specifically, Section 156 restores patent term for certain drug products, medical devices, food additives, and color additives subject to regulatory review prior to marketing by the Food and Drug Administration.

B. Regulation of Term Due to Procedures of the USPTO

1. Applications Filed on or After June 8, 1995

With the adoption of the two-prong approach for determining patent term, Congress turned its attention to the USPTO. Recognizing that certain examination procedures instituted by the USPTO could cause a reduction in term, Congress took the unprecedented step of enacting legislation in 1994 that reinstated term due to delays by the USPTO for patent applications filed on or after June 8, 1995. In particular, Congress granted additional term to a patentee who prevailed on the merits of any legal issue raised regarding a claim in such procedures as interference and appeal.[8]

2. Applications Filed on or After May 29, 2000

After passage of the 1994 legislation, it became apparent to Congress that the procedures being relied on for additional term were too limiting. Consequently, Congress passed

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comprehensive legislation on November 29, 1999 applying to original (i.e., non-reissue) utility (i.e., non-design) patent and plant applications filed on or after May 29, 2000, the date of enactment of the legislation ('the 1999 legislation"). The 1999 legislation had three major components, titled: 1) Guarantee of Prompt Patent and Trademark Office Responses, 2) Guarantee of No More than 3-year Application Pendency, and 3) Reduction of Period of Adjustment. The first two components are of central importance regarding the discussion to follow and cover delays in the patent prosecution process caused by the USPTO and for which the patentee would be rewarded extra patent term beyond the twenty years from filing term. The third component is of interest in that it recognized for the first time that patent applicants themselves could fail to engage in reasonable efforts to prosecute their own patent applications. The 1999 legislation explicitly set forth that the failure of a patent applicant to respond to a USPTO "rejection, objection, argument, or other request" within three months would result in any extension of patent term owed to the patent applicant being reduced by the number of days the patent applicants' response was beyond the three-month time limit.[9] Congress also directed the USPTO to "prescribe regulations establishing the circumstances that constitute a failure of an applicant to engage in reasonable efforts to conclude processing or examination of an application."[10]

a. Guarantees of Prompt Responses and No More than Three-Year Patent Application Pendency

The first two major components of the 1999 legislation previously mentioned are set forth below:

> (A) Guarantee of Prompt Patent and Trademark Office responses.
>
> Subject to the limitations under paragraph (2), if the issue of an original patent is delayed due to the failure of the Patent and Trademark Office to –
>
> > (i) Provide at least one of the notifications under section 132 of this title or a notice of allowance under section 151 of this title not later than 14 months after –
> >
> > > (I) the date on which the application was filed under section 111(a) of this title; or
> > >
> > > (II) the date on which an international application fulfilled the requirements of section 371 of this title;
> >
> > (ii) respond to a reply under section 132, or to an appeal taken under section 134, within 4 months after the date on which the reply was filed or the appeal was taken;
> >
> > (iii) act on an application within 4 months after the date of a decision by the Board of Patent Appeals and Interferences under section 134 or 135 or a decision by a Federal court under section 141, 145, or 146 in a case in which allowable claims remain in the application; or
> >
> > (iv) issue a patent within 4 months after the date on which the issue fee was paid under section 151 and all outstanding requirements were satisfied,
>
> the term of the patent shall be extended 1 day for each day after the end of the period specified in clause (i), (ii), (iii), or (iv), as the case may be, until the action described in such clause is taken.
>
> (B) Guarantee of no more than 3-year application pendency.— Subject to the limitations under paragraph (2), if the issue of an original patent is delayed due to the failure of the United States Patent and Trademark Office to issue a patent within 3 years after the actual filing date of the application in the United States, not including—
>
> > (i) any time consumed by continued examination of the application requested by the applicant under section 132 (b);
> >
> > (ii) any time consumed by a proceeding under section 135 (a), any time consumed by the imposition of an order under section 181, or any time consumed by appellate review by the Board of Patent Appeals and Interferences or by a Federal court; or
> >
> > (iii) any delay in the processing of the application by the United States Patent and Trademark Office requested by the applicant except as permitted by paragraph (3)(C),
>
> the term of the patent shall be extended 1 day for each day after the end of that 3-year period until the patent is issued.[11]

Distilling the above sections, the 1999 legislation placed time limits on the USPTO to respond to certain acts by patent applicants and government bodies per 35 USC § 154(b)(1)(A). In addition, the 1999 legislation presented in 35 USC § 154(b)(1)(B) set a time limit of three years from the date of filing for the USPTO to issue a patent. The patent term is extended one day for each day that the USPTO goes beyond the time limits mentioned above. Also, the patent term extension due to USPTO delay is reduced by the number of days of delay caused by the patent applicant.[12]

b. Treatment of "Overlap" of Multiple Delays

Congress recognized that there would be instances where the USPTO could have multiple delays occurring on the same day. In this situation, the 1999 legislation stated that:

> To the extent that periods of delay attributable to grounds specified in paragraph (1) [35 USC § 154(b)(1)] overlap, the period of any adjustment granted under this subsection shall not exceed the actual number of days the issuance of the patent was delayed. (bracketed material added).[13]

III. USPTO Establishes Patent Term Adjustment Rules

The foundation of patent term adjustment established by Congress presented the USPTO with the opportunity to establish rules concerning the legislation. Indeed, Congress mandated that the USPTO establish regulations to identify circumstances that constituted a failure of a patent applicant

to engage in reasonable efforts to conclude prosecution of a patent application.[14] Congress also directed the USPTO to issue regulations to establish procedures for the application for and determination of any patent term adjustment.[15]

A. USPTO Proposes Its Rules

Faced with the above-mentioned mandates to police itself, the USPTO proposed rules on March 31, 2000 to administer and determine patent term adjustments pursuant to the 1999 legislation.[16] The proposed rules presented fifteen specific instances that would constitute unreasonable efforts by a patent applicant and, therefore, subject the subsequently-issuing patent to a reduced patent term adjustment.[17] The USPTO announced in its proposed rules that no public hearing would be held. Furthermore, the USPTO asserted that there was not sufficient time to conduct a notice and comment rulemaking procedure and accept comments during a sixty-day comment period due to the six month time period from the November 29, 1999 passage date to the May 29, 2000 effective date of the provisions of the Patent Term Adjustment law.[18] The proposed rules also set forth a procedure for determining and petitioning patent term adjustments. The proposed rules were finalized on October 18, 2000 without comments made by the USPTO.

Starting midway in 2003, patents that were filed shortly after May 29, 2000 were being granted. Such patents on their face qualified for a patent term adjustment for being granted more than three years from their filing dates pursuant to 35 U.S.C. § 154(b)(1)(B). During this time frame, this author's law firm identified situations where there could be significant patent term adjustments when other previously occurring delays were added on to the three-year delay. In particular, based on its reading of the statute, the author's law firm determined that USPTO delays that occurred for failure to meet examination deadlines and delays that occurred for failure to grant a patent within three years of filing the application were cumulative in general. Since the USPTO had not previously commented on this scenario, discussions were held with USPTO personnel to confirm that the law firm's interpretation was correct. Instead, the USPTO personnel indicated that this interpretation was in error.[19]

B. USPTO Interprets Congress' Intent on How to Determine Patent Term Adjustment

Based on its knowledge that the author's law firm and several other law firms had a contrary interpretation of calculating three-year delay, the USPTO published its interpretation of how to determine patent term adjustment based on failure to grant a patent within three years of filing the application. In particular, the USPTO amended its Patent Term Adjustment rules in 2004. This amendment included rule 37 C.F.R. §1.703(f) regarding the treatment of the overlap of delays. The 2000 and 2004 versions of Rule 703(f) are set forth in the table at the bottom of the page, wherein deletions made to the 2000 version are bracketed and additions are underlined.

Only one change was made to the rule: by referring to "periods of delay" instead of "periods of adjustment." The change on its face appeared to be for the sole purpose of using language consistent with the statute. However, in its comments to the amended rules, the USPTO stated that the amendments were necessary since the previous rules "misled applicants into believing" that delays that occurred prior to the three-year anniversary of the filing of the patent application do not "overlap" with a delay due to granting a patent after the three-year anniversary. In other words, the USPTO in 2004 interpreted 35 USC § 154(b)(2)(A) prohibition against counting multiple delays that "overlap" as not being confined to situations wherein the delays occur in the same period of time. This interpretation would reduce the amount of delay attributed to the USPTO for granting a patent after the three-year anniversary of the filing of the patent application.

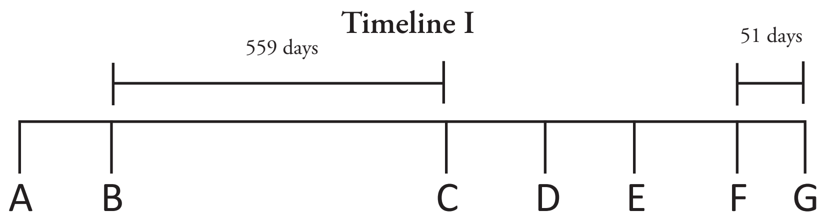
IV. The USPTO is Challenged by Wyeth

A. Petition Filed

Wyeth and Elan Pharma International Ltd. (collectively called "Wyeth") filed a petition with the USPTO that challenged the USPTO's determination of patent term adjustment for their U.S. Patents Nos. 7,179,892 ('the 892 patent") and 7,189,819 ("the '819 patent"). The USPTO calculated extensions of

2000 Version of 37 C.F.R. § 1.703(f)	2004 Version of 37 C.F.R. § 1.703(f)
(f) The adjustment will run from the expiration date of the patent as set forth in 35 U.S.C. 154(a)(2). To the extent that periods of adjustment attributable to the grounds specified in §1.702 overlap, the period of adjustment granted under this section shall not exceed the actual number of days the issuance of the patent was delayed. The term of a patent entitled to adjustment under § 1.702 and this section shall be adjusted for the sum of the periods calculated under paragraphs (a) through (e) of this section, to the extent that such periods are not overlapping, less the sum of the periods calculated under § 1.704. The date indicated on any certificate of mailing or transmission under § 1.8 shall not be taken into account in this calculation.	**(f) The adjustment will run from the expiration date of the patent as set forth in 35 U.S.C. 154(a)(2). To the extent that periods of [adjustment] <u>delay</u> attributable to the grounds specified in §1.702 overlap, the period of adjustment granted under this section shall not exceed the actual number of days the issuance of the patent was delayed. The term of a patent entitled to adjustment under § 1.702 and this section shall be adjusted for the sum of the periods calculated under paragraphs (a) through (e) of this section, to the extent that such periods are not overlapping, less the sum of the periods calculated under § 1.704. The date indicated on any certificate of mailing or transmission under § 1.8 shall not be taken into account in this calculation.**

Timeline I



A=3/12/2003 filing date B=5/12/2004 14-month date C=11/22/2005 Restriction Requirement
D=3/12/2006 3-year anniversary of filing E=8/31/2006 Issue Fee Paid
F= 4 months from payment of Issue Fee G=2/20/2007 grant date of '892 patent

terms for the '892 and '819 patents as 462 days and 492 days, respectively. Wyeth calculated extensions of 756 days and 722 days, respectively.

B. District Court Filing

While Wyeth was waiting for the USPTO's decision to its petition, Wyeth filed suit in the United States District Court for the District of Columbia pursuant to 35 USC § 154(b)(4)(A). For simplicity, only the facts surrounding the prosecution of the '892 patent will be discussed in this article since they illustrate issues of interest similar to those regarding the '819 patent. The '892 patent was filed on March 12, 2003. Pursuant to the U.S. Patent Rules, Wyeth accrued 148 days of delay in prosecution/examination of the patent application. Regarding delays by the USPTO, the USPTO's first official action on the merits was the mailing of a Restriction Requirement on November 22, 2005 that resulted in the USPTO incurring a delay of 559 days for failing to mail a first action on the merits within fourteen months of filing an application pursuant to 35 U.S.C. § 154(b)(1)(A)(i) and 37 C.F.R. §1.703(a)(1) and hereinafter referred to as the "fourteen-month delay." The USPTO incurred an additional delay of fifty-one days for failing to issue the '892 patent by December 31, 2006 within four months of the payment of the Issue Fee according to 35 U.S.C. § 154(b)(1)(A)(iv) and 37 C.F.R. §1.703(a)(6). The '892 patent was granted on February 20, 2007.

During the district court case, both Wyeth and the USPTO agreed that Wyeth had delayed prosecution by 148 days. In addition, Wyeth and the USPTO agreed that the USPTO had committed delays in the amount of 610 days, as represented by the bracketed areas in Timeline I at the top of this page.

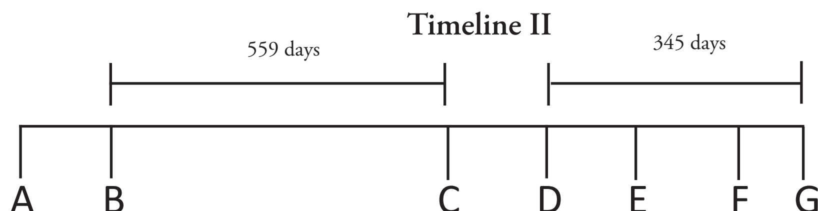
The main issue between Wyeth and the USPTO was whether the USPTO should be charged for additional delays for failing to issue a patent within three years of filing the application pursuant to 35 U.S.C. § 154(b)(1)(B) and 37 C.F.R. §1.703(b). The USPTO asserted that while the delay occurred, the statute and rules prevented counting the delay since it "overlapped" with another delay. Wyeth asserted that the delay should be counted.

Wyeth's position was that additional delay should be attributed to the USPTO since the '892 patent was granted on February 20, 2007, which is 294 days after March 12, 2006, the three-year anniversary of the filing of the '892 patent. Wyeth's position, illustrated below in timeline II, adds the three-year delay represented by the bracketed areas below to timeline I.

Wyeth's calculation of the delay by the USPTO came to a total of 853 days, the sum of the fourteen-month delay of 559 days and 345 days resulting from the delay for failing to grant a patent three years from the filing date ("the three-year delay"). Note that the previously mentioned delay of fifty-one days shown in timeline I was not counted by Wyeth pursuant to 35 USC § 154(b)(2)(A) and 37 C.F.R. § 1.703(f) since it overlapped in time with the three-year delay shown by the right side bracket shown in timeline II. Thus, the total delay and patent term extension calculated by Wyeth was 756 days (559 days + 345 days – 148 days).

In contrast, the USPTO asserted that timeline I applied to the situation at hand. The USPTO's assertion was based on its interpretation of 35 USC § 154(b)(2)(A) set forth in the previously-mentioned interpretation of the 2004 change to the overlap provision of 37 C.F.R. § 1.703(f). From the USPTO's perspective, a three-year delay could begin prior to the three-year anniversary of the filing of the application. In the case of the '892 patent, the USPTO's position was that the three-year delay was caused by the previous delay of 559 days by the USPTO to render an action on the merits within 14 months of the filing date. Thus, the USPTO asserted that Wyeth would be rewarded twice for the same delay under Wyeth's interpretation and, thus, the fourteen-month delay and the three-year delay "overlapped" one another. Such double compensation was not

Timeline II



Congress' intent, and Wyeth only merited the larger of the two delays, not both combined, as shown in the first timeline. Under the USPTO's interpretation, the total delay was 462 days (559 days + 51 days – 148 days).[20]

C. District Court Strikes Down USPTO's Rule

Wyeth and the USPTO both filed motions for summary judgment in the district court based on the positions mentioned above. The district court first determined that the USPTO's interpretation of its rule was not entitled to deference under *Chevron v. NRDC*.[21] The district court found that the USPTO in general "does not have the authority to issue substantive rules, only procedural regulation regarding the conduct of proceedings before the agency" pursuant to 35 U.S.C. § 2(b)(2)(A).[22] Regarding the Patent Term Adjustment statute at hand, the district court further found that Congress gave the USPTO the power to "prescribe regulations establishing circumstances that constitute a failure of an applicant to engage in reasonable efforts to conclude processing or examination of an application" pursuant to 35 U.S.C. § 154(b)(2)(C)(iii).[23] The Patent Term Adjustment statute was silent regarding giving the USPTO the power to interpret the meaning of a particular term in the Patent Term Adjustment statute. Therefore, the district court held that *Chevron* did not apply to the USPTO's interpretation of "overlap."[24] Even if *Chevron* did apply, the district court held that the plain meaning of the statute prevented the USPTO's interpretation of "overlap" to be applied. In explaining its holding, the district court pointed out that "[t]he problem with the PTO's interpretation is that it considers the application *delayed* under § 154(b)(1)(B) during the period *before it has been delayed*."[25]

D. The CAFC Strikes the Rule Down a Second Time

The USPTO appealed the district court's ruling to the Court of Appeals for the Federal Circuit (CAFC). On January 7, 2010, the CAFC affirmed the district court's decision in large part for reasons relied on by the district court. The CAFC held that the language of 35 USC § 154(b)(2)(A) was "clear that no 'overlap' happens unless the violations occur at the same time."[26]

The CAFC addressed a number of the issues raised by the USPTO. For example, the USPTO argued that its interpretation of the overlap language was consistent with Congress' intent to cap the term of any patent to seventeen years when the amount of three-year delay was greater than delays based on a failure to meet examination deadlines.[27] The CAFC pointed out that the legislative history of the statute tells a different story. The following comment presented in the Conference Report of the House of Representatives is enlightening on this point:

> [S]ubtitle D removes the 10-year caps from the existing provisions, adds a new provision to compensate applicants fully for USPTO-caused administrative delays, and, for good measure, including a new provision guaranteeing diligent applicants at least a 17-year term by extending the term of any patent not granted within three years of filing. Thus, no patent applicant diligently seeking to obtain a patent will receive a term of *less than 17 years* as provided under the pre-GATT standard; *in fact, most will receive considerably more*.[28]

Based in part on the legislative history set forth above, the CAFC held that Congress intended that the statute should provide a minimum seventeen-year term for most patents.[29]

V. The USPTO Changes Its Ways?

A. USPTO Response to Wyeth*—No Appeal and Interim Procedures*

Shortly before the decision by the CAFC, the Senate confirmed David J. Kappos as the Under Secretary of Commerce for Intellectual Property and Director of the USPTO. Director Kappos made the decision that the USPTO would *not* appeal or request reconsideration of the decision made by the CAFC. On January 26, 2010, Director Kappos took steps to establish interim patent term adjustment-related procedures to be in effect until March 2, 2010, the scheduled date for the revision of the USPTO software used to calculate patent term adjustment in accordance with the decision of the CAFC. In addition, Director Kappos *sua sponte* waived the rules regarding deadlines for petitions requesting reconsideration of the patent term adjustment based solely on the CAFC's decision for patents granted within 180 days prior to March 2, 2010. Patent term adjustment petitions for patents granted before the 180 day cut-off would be denied as untimely due to the 180-day deadline to file a civil action in the United States District Court for the District of Columbia.[30] Patent term adjustment petitions for patents granted on or after March 2, 2010 would be processed as other patent term adjustment petitions were processed prior to January 26, 2010.

B. USPTO Can Do More to Redress Patentees' Demands and to Avoid Potential Procedural Trap

The above actions by Director Kappos arguably provide evidence that the USPTO has changed how it is responding to Congress regarding examination delays caused by the USPTO. More can be done by the USPTO to address the demands of patentees. For example, Director Kappos has the power to prescribe regulations establishing procedures to determine patent term adjustments.[31] It could be argued that such power extends to prescribing regulations to rescind previous erroneous determinations with *Wyeth* issues that were made for patents granted prior to March 2, 2010 and perform another determination of the patent term adjustment.[32] As an alternative, corrective patent term adjustments could be made for those patents in which patent term adjustment petitions were filed and *Wyeth* issues that were raised were denied by the USPTO.

The rescinding of patent term adjustments is especially important for patents granted within 180 days prior to March 2, 2010 and with petitions for reconsideration filed prior to January 26, 2010. In particular, the USPTO is required to give an applicant *only one* chance to request reconsideration of a patent term adjustment determination by the Director.[33] The interim procedures arguably give an applicant *two* chances to request reconsideration. This could lead to misleading an applicant who filed a request for reconsideration prior to January 26, 2010 that did not raise *Wyeth* issues and then filed a subsequent request that solely contained *Wyeth* issues. In such a scenario, the second request for reconsideration is arguably

invalid. Since the applicant was led to believe that the second request for reconsideration was proper, the applicant may not think to protect his or her rights regarding *Wyeth* by filing a civil action with the United States District Court for the District Court for the District of Columbia, as permitted by 35 U.S.C. § 154(b)(4)(A).

VI. Conclusion

Wyeth is an interesting study on how an administrative agency, such as the USPTO in this case, reacts to a congressional statute enacted to spur the agency to correct a perceived deficiency of the agency. As the district court and, subsequently, the CAFC determined, the USPTO chose not to adequately address the deficiency with the rules it created. The CAFC's affirmance of the district court appears to have caused the USPTO to rethink its response. While the USPTO did not fully redress the demands of patentees, the patent community may pressure the USPTO to issue corrective patent term adjustments and fix related potential procedural problems in the near future.

Endnotes

1 "Congress shall have the power . . . to promote the progress of science and useful arts by securing for *limited times* to authors and inventors the exclusive right to their respective writings and discoveries." U.S. Const. art. I, § 8 (emphasis added).

2 Chisum, 16.04[1].

3 *Id.*

4 *Id.*

5 35 U.S.C. 154(a)(2).

6 35 U.S.C. §§ 155, 156.

7 35 U.S.C. § 155A.

8 35 U.S.C. § 154(b).

9 35 U.S.C. § 154(b)(2)(C)(i)-(ii).

10 35 U.S.C. § 154(b)(2)(C)(iii).

11 35 USC § 154(b)(1)(A)-(B).

12 35 USC § 154(b)(1)(C)(i).

13 35 USC § 154(b)(2)(A).

14 35 U.S.C. § 154(b)(2)(C)(iii).

15 35 U.S.C. § 154(b)(3)(A).

16 Fed. Reg. Vol. 65, No. 63, 3/31/2000.

17 37 C.F.R. § 1.704(c)(1)-(15).

18 It should be noted that the USPTO offered to receive comments that would be available for public inspection. Some rules were changed in response to the comments.

19 While the USPTO asserted a different position, the author's law firm continued to calculate patent term adjustments based on both its interpretation and that of the USPTO in case a client wished to challenge the USPTO's interpretation.

20 Note that under the USPTO's interpretation, an additional delay of fifty-one days between points F and G of the first timeline was incurred since the delay due to late granting of the patent was not caused by the fourteen-month delay between points B and C.

21 467 U.S. 837 (1984).

22 Wyeth v. Dudas, 580 F. Supp. 138, 141 (D.D.C. 2008). Jon W. Dudas was the Under Secretary of Commerce for Intellectual Property and Director of the U.S. Patent and Trademark Office at the time of Wyeth's filing in the district court.

23 *Id.*

24 *Id.*

25 *Id.* at 142 (italics as original).

26 Wyeth v. Kappos, 93 U.S.P.Q.2d 1257, 1260 (Fed. Cir. 2010). Jon W. Dudas was eventually replaced by David J. Kappos on August 7, 2009.

27 *Id.* at 1261.

28 H.R. Rep. No. 106-464, at 125 (1994) (emphasis added).

29 Wyeth v. Kappos, 93 U.S.P.Q.2d 1257, 1260 (Fed. Cir. 2010).

30 *See* 35 U.S.C. §154(b)(4).

31 35 U.S.C. §154(b)(3)(A).

32 Based on an unscientific sampling of the author's docket of cases patented from 2006 to 2009, around nine percent of the patents had *Wyeth* issues.

33 35 U.S.C. § 154(b)(3)(B)(ii).

International & National Security Law

Obama's War Law

*By Robert J. Delahunty**

Among the critics of the Bush Administration's legal policies in the "war on terror," few were more unrelenting or more vituperative than Harold Koh, then the Dean of Yale Law School.[1] With the change of Administrations, Dean Koh has become the Legal Adviser to the U.S. Department of State. In that capacity, he addressed the annual meeting of the American Society of International Law last March on the topic *The Obama Administration and International Law.*[2] In some circles, Koh's remarks caused shock and dismay. Dean Koh met Legal Adviser Koh, and Legal Adviser Koh, it turned out, had come to accept many of the basic premises and practices of the Bush Administration. Although there are undeniable differences of emphasis and even of policy between the two Administrations, many of the innovations Koh described make little difference in practice, and some might even be described as cosmetic.[3] Koh's readers could reasonably conclude—as others had done before—that "[a]lmost all of the Obama changes have been at the level of packaging, argumentation, symbol, and rhetoric."[4] Certainly the continuities in the legal policies of the two Administrations are marked and substantial.[5]

In this brief paper, I will focus on three main areas of continuity: the Obama Administration's reliance on the "war paradigm" rather than the "law enforcement" or "crime" paradigm; its understanding and application of the Geneva Conventions of 1949; and most importantly (because Koh's speech emphasized the subject) its practice of "targeted killings."

The War Paradigm

Almost since the attacks on 9/11, legal experts have debated whether the United States was "at war" with al Qaeda and its Taliban supporters, or rather had been the victim of a mass atrocity committed by a criminal syndicate.[6] The appropriate legal strategy for the United States depended on which answer was given. If the "war" paradigm applied, the United States' legal strategy would be governed by the law of armed conflict. Under that body of law, enemy combatants may lawfully be targeted and killed by the opposing belligerent's forces.[7] They may also be captured and detained indefinitely without criminal charges, or tried by military commissions on charges of war crimes. If, however, the "crime" paradigm applied, the normal rules governing the conduct of domestic law enforcement agencies would govern. The use of lethal force would be restricted; detention would be lawful only if criminal charges were lodged; and any criminal trials would have to be held before ordinary Article III civil courts. Many critics of the Bush Administration argued that the "crime" paradigm applied. The Bush Administration maintained that the United States was *at war* with al Qaeda and Taliban.

That position formed the fundamental premise of the Bush Administration's legal policy. On the international law side, the policy was anchored in the inherent right of national self-defense recognized by article 51 of the United Nations Charter, in a series of Security Council Resolutions starting with S.C. Res. 1386 (2001) and continuing up to the present,[8] and in the actions of NATO in the immediate aftermath of the 9/11 attacks.[9] On the domestic side, it relied on the Authorization for the Use of Military Force (AUMF) enacted by Congress in 2001,[10] and on the rulings of the Supreme Court.[11]

Those hoping that the Obama Administration would abandon the war paradigm must have been sorely disappointed by Koh's remarks. Noting that some have asked on what legal basis the United States is continuing to detain those held in Guantanamo and Bagram,[12] Koh answered:

> We continue to fight a war of self-defense against an enemy that attacked us on September 11, 2001, and before, and that continues to undertake armed attacks against the United States. . . . [I]n Afghanistan, we work as partners with a consenting host government. And . . . the United Nations Security Council has, through a series of successive resolutions, authorized the use of "all necessary means" by the NATO countries constituting the International Security Assistance Force (ISAF) to fulfill their mandate in Afghanistan.[13]

On the domestic legal side, Koh—again following the Bush Administration—rooted the authorization for the use of military measures against al Qaeda and Taliban, including detention, in the AUMF: "[a]s a matter of domestic law, Congress authorized the use of all necessary and appropriate force through the . . . AUMF."[14] On the fundamental question of the legitimacy of using the war paradigm, there is no difference between the two Administrations.

Indeed, in one subtle respect, the convergence is even more striking—if also unacknowledged. Koh finds a legal foundation for the war against al Qaeda and Taliban in the right of self-defense.[15] But under the rulings of the International Court of Justice (ICJ), there is *no* right of self-defense against a non-state actor (such as al Qaeda and, now, Taliban).[16] Koh glides over this issue in silence.

The Geneva Conventions

Once it is accepted that the war paradigm applies, it follows that the law of war (also called international humanitarian law) specifies the United States' rights and duties as a belligerent. Three major documents in the law of war are particularly relevant: the third and fourth of the four 1949 Geneva Conventions, and the first of the two 1977

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"Additional Protocols" to the 1949 Geneva Conventions. The third Geneva Convention (the POW Convention[17]) defines the criteria for being accorded the legal status of a prisoner of war, and specifies the powers and duties of a detaining Power toward such captives. The fourth Geneva Convention (the Civilian Convention[18]) defines the legal status and protections of a civilian non-combatant during wartime. The United States decided not to ratify the first of the two Additional Protocols to the Geneva Conventions (AP I[19]) on the grounds that some of its provisions "unduly favored irregulars and terrorists, and would endanger the civilian population among whom such persons might attempt to hide."[20] Nonetheless, some of AP I's clauses have been said to reflect customary international law.[21] Of particular relevance, the United States accepts the "principle of distinction" and the "principle of proportionality," both of which are codified in AP I. The principle of distinction is "[a]t the very heart of the law of armed conflict."[22] In Koh's words, it "requires that attacks be limited to military objectives and that civilians or civilian objects shall not be the object of the attack."[23] Koh explains the principle of proportionality as "prohibit[ing] attacks that may be expected to cause incidental loss of civilian life, injury to civilians, damage to civilian objects, or a combination thereof, that would be excessive in relation to the concrete and direct military advantage anticipated."[24]

In applying this body of law to the armed conflict between the United States and al Qaeda/Taliban, at least four important legal questions arose.

First, if the United States armed forces captured members of the al Qaeda/Taliban forces and detained them (as they have done and are still doing in Guantanamo Bay and Bagram), are those detainees entitled to the legal status of prisoners of war under the POW Convention?

Second, are members of those forces instead protected as civilians under the Civilian Convention?

Third, is there yet another legal category—unprivileged or illegal combatant[25]—that applies to al Qaeda/Taliban forces, such that (unlike civilians) they can legitimately be targeted or, if captured, detained, but also such that (unlike prisoners of war) they do not enjoy the full measure of the POW Convention's protections, such as immunity from criminal prosecution for their use of force in combat?[26] Critics of the Bush Administration argued with considerable vehemence that al Qaeda/Taliban detainees could only be *either* civilians under the Civilian Convention *or* prisoners of war under the POW Convention[27]: the claim that there was a third category was said by some scholars to create a supposed "legal limbo" or "black hole" for the detainees.[28] Then-Dean Koh himself derided the Bush Administration in 2004 for seeking to create "extra-legal zones, most prominently in Guantanamo Bay, where . . . extralegal persons, particularly those detainees labeled 'enemy combatants'" were held.[29]

Fourth, notwithstanding the fact that the United States has not ratified AP I, was it bound to accept that treaty's way of drawing the distinction between combatants and civilians? On the answers given to these questions hinged the legality under international law of the United States' targeting and detention policies.[30]

How does the Obama Administration answer these questions? In each case, its answers seem to be essentially the same as those of the Bush Administration.

Does the POW Convention Apply? The Obama Administration does not believe that the detainees are entitled to the status of "prisoners of war" under the POW Convention. Although Koh avoids dealing candidly with this question, the Obama Administration's conduct would be inexplicable—and illegal—if it held any other view. As Professor Robert Turner points out, Article 84 of the POW Convention states that "[a] prisoner of war shall be tried only in a military court," and Article 97 states that "[p]risoners of war shall not in any case be transferred to penitentiary establishments (prisons, penitentiaries, convict prisons, etc.) to undergo disciplinary punishment therein."[31] Attorney General Holder's decision to prosecute five Guantanamo detainees, including Khalid Sheik Mohammed, before federal district courts[32] would only be permissible if those detainees were *not* prisoners of war.

Critics also assailed the Bush Administration because it claimed to be authorized to hold the Guantanamo detainees until the end of the conflict, i.e., for the indefinite future. In effect, it was said, this amounted to life imprisonment without trial. Koh remarks in passing that courts, following the Obama Administration's arguments, "have accepted the overall proposition that individuals can be subject to law of war detention *for the duration of the current conflict*."[33]

Does the Civilian Convention Apply? Koh bases the United States' legal right to hold al Qaeda and Taliban detainees in Guantanamo and Bagram on the assumption that they are (or were) *combatants,* not *civilians*.[34] True, he prefers to call them "belligerents"[35] rather than "enemy combatants."[36] Setting aside whether the change in nomenclature is more than cosmetic,[37] the key point is that, for this Administration as for the last, the detainees are *not* "civilians" protected by the Civilian Convention. The Obama Administration has announced that at least forty of the Guantanamo detainees will be held indefinitely without trial[38]—a legally indefensible position if they were protected as civilians.[39] Attorney General Holder's position that the law of war would permit the resumed detention of Khalid Sheik Mohammed even if he were acquitted at his civilian trial is further evidence that the Obama Administration regards him and those like him as combatants rather than as civilians.[40] Still more clearly, al Qaeda and Taliban members could not be intentionally targeted for killing in Afghanistan, Pakistan, and elsewhere if they enjoyed the status of civilians.[41]

Does AP I's Test of the Combatant/Civilian Distinction Apply? Koh implicitly rejects the—enigmatic[42]—test of non-combatant status set out in AP I. That test would hold that those who are not members of the regular armed forces of a belligerent are civilians "unless and for such time as they take *a direct part in hostilities*."[43] In its 2006 *Targeted Killings Case*,[44] the Supreme Court of Israel adopted that test, and it is strenuously advocated by the International Committee of the Red Cross (the ICRC).[45] Rather than relying on it, however, Koh now affirms a much broader view of combatant status. For him, the appropriate test

includes, but is not limited to, whether an individual joined with or became part of al-Qaeda or Taliban forces or associated forces, which can be demonstrated by relevant evidence of formal or functional membership, which may include an oath of loyalty, training with al-Qaeda, or taking positions with enemy forces. . . . [W]e disagree with the International Committee of the Red Cross on some of the particulars.[46]

Koh's disagreement with the ICRC is understated, to say the least.[47] In general, the ICRC's view is as follows:

> [a]ny member of the armed forces of a State is a legitimate target at all times, including the cook, the cleaner and the lawyer. . . [but] non-State forces individuals who do not have a continuous combat function will be civilians and therefore immune from direct attack unless they engage in a specific act which amounts to direct participation in hostilities, and only for such time.[48]

So, for example, the ICRC maintains that the driver of a truck who transports ammunition from a factory to a port for further shipping to a storehouse in a conflict zone is a civilian, and so immune from attack—even if the driver is an al Qaeda or Taliban member or supporter.[49] For Koh, on the other hand, the fact that the truck driver was "formally" a member of al-Qaeda by virtue of having taken an oath, or was "functionally" a member because he had trained with it, would suffice to render him a combatant and, hence, a legitimate target for killing.

To take an even clearer example, a 2009 Report to the U.S. Senate Foreign Relations Committee disclosed that the U.S. military was targeting Afghan drug lords suspected of financing the Taliban. According to the Report, "[t]he military places no restrictions on the use of force with these selected targets, which means they can be killed or captured on the battlefield."[50] Presumably Koh is aware of the military's targeting decision and considers it to be lawful. And so it may well be, on his understanding of combatant status. But it is plainly unlawful on the ICRC's interpretation, which would prohibit targeting those who provide combat service support, including financing, to groups like al Qaeda or Taliban.[51]

It is ironic to compare Koh's positions as Legal Adviser with the views he expressed in his 2004 Supreme Court amicus brief in the *Padilla* case.[52] There he appeared to endorse AP I's test of non-combatancy, arguing that in calling Padilla an "enemy combatant," the government had elided "the crucial distinction between actual *combatants* taking a *direct* part in hostilities . . . and *civilians* who may be subject to criminal trial in civilian courts for acts of espionage or treason in aid of an enemy power" (emphases in original).[53] Elsewhere, too, he affirmed that only those civilians "taking a *direct* part in the hostilities" may be detained by the military (original emphasis).[54] Applying the AP I test, Koh argued that José Padilla (whom his brief described merely as someone "alleged to have conspired abroad with al-Qaeda . . . to commit terrorist acts in the United States at some indefinite time in the future"[55]) was a *civilian,* not a combatant.[56] Yet under the tests Koh currently posits for combatant status, Padilla would unquestionably count as a *combatant* (as the Bush Administration argued in *Padilla*[57]), not as a civilian. Finally, in his *Padilla* Brief, Koh complained that "the Government makes no pretense that Padilla is being held for trial: he is simply being detained without any stated time limit for the duration of a global 'war on terrorism' that has no foreseeable end."[58] Now, as Legal Adviser, he remarks imperturbably that detainees may be held "for the duration of the current conflict."[59]

Targeted Killings

The Obama Administration has taken pride in its numerous missile and other attacks on targeted terrorist suspects in countries such as Yemen and Pakistan.[60] Obama's CIA Director Leon Panetta has described the drone strikes in Pakistan as "the only game in town in terms of confronting or trying to disrupt the al Qaeda leadership."[61] Indeed, the number of drone attacks during the Obama Administration's first year reportedly exceeded the total for the Bush Administration's eight years.[62] Koh defends the practice of targeted killings against several legal criticisms, but fails to grapple with the most serious objections that have been made to the policy. There are at least three questions that deserve far closer and more sustained consideration.

Pakistani Sovereignty. First, the United States conducted fifty-three U.S. missile strikes on targets in the tribal regions of Pakistan in 2009 alone. Do these strikes constitute a violation of Pakistan's territorial sovereignty? The answer to this would be "No," if—as some surmise—Pakistan has secretly consented to the program.[63] But there is uncertainty about Pakistan's true attitude: in an interview last December with *Der Spiegel,* Pakistani Prime Minister Syed Yousuf Raza Gilani stated that the drone strikes are "counterproductive in the sense that [they are] creating a lot of anti-American sentiment all over the country."[64] Indeed, one legal scholar has even contended recently that not only is the U.S. unable to "point to invitations from Pakistan for most of its drone attacks," but that "even express consent by Pakistan would not justify their use."[65]

If Pakistan has *not* consented to the drone program, the question becomes harder: under ordinary use-of-force rules in international law, the fact that Taliban forces located in Pakistan had launched attacks on U.S. and NATO forces might not be sufficient to justify an armed intervention by the latter into Pakistan's territory.[66]

The United States might, however, respond by pointing to the series of Security Council Resolutions mentioned earlier, culminating in last October's S.C. Res. 1890 (2009), for authorization to invade Pakistan's territorial sovereignty if that action was necessary for carrying out its mission against al Qaeda and Taliban forces in Afghanistan.[67] The argument would be that the member states of the United Nations, including Pakistan, have an obligation under article 25 of the U.N. Charter to "accept and carry out" the Security Council decisions, and that (especially when the Council is acting under its Chapter VII authority) this obligation may require them to cede their claim to territorial sovereignty in appropriate cases. One possible precedent that might be cited is S.C. Res. 688 (1991), which demanded that Iraq, "as a contribution to removing the threat to international peace and security in the region" in the aftermath of the First Gulf War, end its repression of the Iraqi civilian population, including that in Kurdistan. The

United Kingdom, followed by the United States and France, interpreted S.C. Res. 688 as authorizing the creation of two "no-fly" zones in Iraq, in abridgement of Iraqi sovereignty.[68] Another possible precedent is S.C. Res. 1244 (1999), which authorized NATO to form and lead the Kosovo Force (KFOR) to defend Kosovo—then still a province of Serbia—from renewed Serb attacks. S.C. Res. 1244 effectively severed part of the territory of Serbia from what the Resolution itself recognized as its sovereign government and authorized an outside military force to occupy and secure it.[69] But there is some legal authority, based on the principles of the U.N. Charter, against the claim that the Security Council can authorize the abrogation of Pakistani territorial sovereignty.[70] And even if the Council could do so, a close reading of the relevant Resolutions may not support the argument that the Council has in fact done so, even implicitly.[71] An argument in defense of U.S. strikes inside Pakistan would therefore need to be developed. Or it simply may not matter: presidential candidate Obama stirred up controversy by saying that if elected, he might bomb Pakistan.[72]

The Principle of Proportionality. Second, there is the requirement that the targeted killings accord with the principle of proportionality, discussed earlier. Other than conclusory assurances that the requirement is satisfied, however, Koh does little to explain how the principle is being applied. For instance, he does not specify whether the proportionality principle is being applied to the targeted killing program in Pakistan as a whole, to some discrete segments of it, or to each individual strike.[73] He does not provide estimates of the numbers of militants and noncombatants killed in the program, although some estimates suggest a rather low level of civilian casualties.[74] He does not clarify what level of certainty is required before launching a strike that the intended target is indeed an al Qaeda or Taliban operative—a true, not a false, positive. He does not identify any of "the concrete and direct military advantage[s]" obtained from the strikes. Nor, in general, does he even begin to sketch out the overall costs and benefits of the drone program.

The Obama Administration's legal advisers and policy makers owe the American public, the people of Pakistan, and world opinion a fuller accounting. The Obama Administration's drones program is causing other nations' militaries to follow our lead, including those of the U.K., Germany, and Pakistan; one leading expert on contemporary warfare even contends that the impact of the new technology is comparable "with the introduction of gunpowder, the printing press or the airplane."[75]

Even setting apart "collateral damage" to Pakistani civilians and their property, the overall costs of the drone program may be significant. Polling data show that only nine percent of Pakistanis approve the program,[76] notwithstanding that the Pakistani public has suffered from the Taliban's depredations.[77] Targeted killing programs (which often depend on the assistance of local collaborators) tend to provoke moral outrage and to intensify hatreds between enemies.[78] Killing terrorists instead of capturing and interrogating them may preclude the discovery of valuable intelligence information.[79] The drone program may even be provoking retaliation against American civilians inside the U.S.[80]: Attorney General Holder has indicated that the recent attempt to set off a car bomb in Times Square, attributed to a U.S. citizen of Pakistani descent, may have been planned and even financed by the Taliban.[81] On the other hand, targeted killing programs may hold Pakistani civilian casualties to a minimum, immobilize or decapitate the militants' leadership, disrupt their operations, and demoralize their forces to an unusual degree.

The Applicability of Human Rights Law. Third, Koh dealt only briefly with the objection recurrently posed by advocates of international human rights law that "the use of lethal force against specific individuals fails to provide adequate process and thus constitutes *unlawful extrajudicial killing*."[82] Unmentioned in his address were the facts that in 2004, the United Nations Commission on Human Rights had made precisely that complaint against the United States' use of drone missiles to kill suspected al Qaeda targets, and that the Bush Administration had vigorously defended the legality of the practice. Koh's defense differs little (except in its taciturnity) from the Bush Administration's.[83] Here again, there was a major but unacknowledged convergence of legal views between the two Administrations.

If Koh returns to the legality of targeted killing of al Qaeda and Taliban terrorist suspects, he should deal far more adequately with the human rights objection that targeting an un-uniformed combatant is akin to outlawing and sentencing him without trial—something more like killing individuals by paramilitary death squads than ordinary military combat. In my opinion, there are legally and morally persuasive answers to that objection.[84] But the problem is a serious one that deserves something more than Koh's shallow and evasive response. The U.N. Special Rapporteur for Extrajudicial, Summary or Arbitrary Executions has recently questioned the legality of the Obama Administration's drones program, and Professor Mary Ellen O'Connell of the University of Notre Dame Law School has condemned it as illegal.[85] If the Obama Administration continues to laud its drone program, it should come forward with better reasoned legal and policy defenses of it. Stealth weaponry should no longer be defended by stealth lawyering.

If nothing else, Koh and other Obama Administration legal officials need to reckon with the possibility that their erstwhile allies in the human rights movement may eventually attack them. "[W]ithout an articulated legal basis for the attacks, U.S. officials could in the future be targeted themselves—by crusading judges in other countries who see targeted killings as violations of humanitarian law."[86] The threat is not an empty one: the UNHRC's Special Rapporteur Philip Alston recently warned that "if targeted killing violates [international law], . . . the author, *as well as those who authorized it*, can be prosecuted for war crimes."[87]

Conclusion

As we approach the mid-point of Obama's current term, how does the legal landscape of what used to be called "the war on terror" look? According to the highest legal authorities in our executive branch, including the State Department Legal Adviser, the nation is still in a state of war with its terrorist enemies. The detention facilities at Guantanamo are still operating. The Geneva Convention on Prisoners of War does not apply to any

of the detainees there. From the Administration's perspective, the detainees there are unlawful or unprivileged combatants, falling into a legal crevice between the Third and Fourth Geneva Conventions. Some of those detainees are being tried before military commissions. Others will remain in detention, without charges, until the conflict with our non-state adversaries has ended—i.e., as far out as the eye can see. The Administration argues that the courts lack jurisdiction to afford habeas relief to alien detainees held at the Bagram detention facility in Afghanistan. The International Court of Justice's use-of-force rulings are disregarded. The guidance of the International Committee of the Red Cross on non-combatancy goes unheeded. The United States remains outside the Rome Statute that created the International Criminal Court. Extraordinary renditions continue.[88] The policy of targeting individualized al Qaeda and Taliban suspects for killing—despite being condemned by the UN Human Rights Council—has been ramped up to an unprecedented degree of violence.

An unbiased observer might conclude that there has been little significant change in the landscape since at least the second term of the Bush Administration. Some disillusioned Obama supporters will agree, and deplore that outcome. Other more hopeful Obama supporters will argue that the changes in style, if not substance, have at least improved the United States' reputation in the world. Still other Obama supporters will point to evidence of material changes, such as Attorney General Holder's decision to try Khalid Sheik Mohammed in a federal district court in Manhattan.

And others will say that once the political campaigns are over, the cold, blue steel of international reality proves unyielding.

Endnotes

1 *See, e.g.,* Harold Hongju Koh, *Can the President Be Torturer in Chief?*, 81 Ind. L.J. 1145 (2006); Harold Hongju Koh, *Setting the World Right*, 115 Yale L.J. 2350 (2006); Harold Hongju Koh, *The Case against Military Commissions,* 96 Am. J. Int'l L. 337 (2002).

2 Harold Hongju Koh, Legal Adviser, U.S. Department of State, Remarks at the Annual Meeting of the American Society of International Law: The Obama Administration and International Law (Mar. 25, 2010), *available at* http://www.state.gov/s/l/releases/remarks/139119.htm (hereinafter *OAIL*).

3 For example, Koh identified as an "important difference[] from the legal approach of the past Administration" the Obama Administration's decision, as a matter of domestic law, not to "base[] its claim of authority to detain those at GITMO and Bagram on the President's Article II authority as Commander-in-chief." *OAIL* at 10. The Bush Administration did indeed take the position that the President had the Article II authority in question, but as an *argument in the alternative* that the Supreme Court noted but did not address in *Hamdi v. Rumsfeld,* 542 U.S. 507 (2004) (plurality op.) ("We do not reach the question whether Article II provides such [detention] authority, . . . because we agree with the Government's alternative position, that Congress has in fact authorized Hamdi's detention."). Furthermore, Koh was careful not to say that the Obama Administration had affirmatively *rejected* any claim to sole executive authority.

4 Jack Goldsmith, *The Cheney Fallacy: Why Barack Obama is Waging a More Effective War on Terror than George W. Bush,* The New Republic (May 18, 2009), *available at* /http://www.tnr.com/article/politics/the-cheney-fallacy?id=1e733cac-c273-48e5-9140-80443ed1f5e2. Likewise, Bradford Berenson of the White House Counsel's legal staff under the Bush Administration, told *The New Yorker* that "from the perspective of a hawkish Bush national-security person the glass is eighty-five per cent full in terms of continuity." Jane Mayer, *The Trial: Eric Holder and the Battle over Khalid Sheik Mohammed,* New Yorker, Feb. 15, 2010, *available at* http://www.newyorker.com/reporting/2010/02/15/100215fa_fact_mayer.

5 A former State Department Legal Adviser in the Bush Administration has also underscored the continuities in the two Administrations' views on international law. *See* John B. Bellinger III, *More Continuity Than Change,* N.Y. Times, Feb. 15, 2010, http://www.nytimes.com/2010/02/15/opinion/15iht-edbellinger.htm.

6 *Compare, e.g.*, Christopher Greenwood, *International Law and the "War Against Terrorism,"* 78 Int'l Aff. 301, 307–09, 314–16 (2002), *and* Daniel Statman, *Targeted Killing,* 5 Theoretical Inquiries L. 178, 183–85 (2004) *with* Frédéric Mégret, *'War'? Legal Semantics and the Move to Violence,* 13 Eur. J. Int'l L. 361 (2002). *See generally* Monica Hakimi, *International Standards for Detaining Terrorism Suspects: Moving Beyond the Armed Conflict-Criminal Divide*, 33 Yale J. Int'l L. 369, 376–79 (2008).

7 The eighteenth-century Swiss philosopher Jean-Jacques Rousseau stated the still- applicable rule as follows: "The object of the war being the destruction of the hostile State, the other side has the right to kill its defenders, while they are bearing arms . . . ." Jean-Jacques Rousseau, The Social Contract 171 (G.D.H. Cole trans. 1973) (1762).

8 The most recent in this series of resolutions is S.C. Res. 1890 (2009), in which the Council

> reiterat[ed] its support for the continuing endeavours by the Afghan government, with the assistance of the international community, including the [International Security Assistance Force (ISAF)] and the Operation Enduring Freedom (OEF) coalition, to improve the security situation and to continue to address the threat posed by the Taliban, Al-Qaida and other extremist groups.

In operative paragraphs 1 & 2, the Council extended ISAF's authorization for a further year and authorized "the Member States participating in ISAF to take all necessary measures to fulfill its mandate." ISAF is the NATO-led security mission operating throughout Afghanistan; OEF is the U.S.-led combat force.

9 *See* Press Release, North Atlantic Treaty Organization, Statement by the North Atlantic Council (Sept. 12, 2001), *available at* http://www.nato.int/docu/pr/2001/p01-124e.htm.

10 Authorization for Use of Military Force, Pub. L. No. 107–40, 115 Stat. 224 (2001).

11 Hamdan v. Rumsfeld, 548 U.S. 557, 594–95 (2006); Hamdi v. Rumsfeld, 542 U.S. 507, 518 (2004).

12 For example, Gabor Rona, the International Legal Director of Human Rights First, has maintained that in "wars between states and non-state armed groups . . . detention authority does not exist." Gabor Rona, *Obama Administration Must Define 'Enemy Combatant' Consistent with Traditional Laws of War* (Feb. 17, 2009), *available at* http://www.law.pitt.edu/hotline/2009/02/obama-administration-must-define-enemy.php.

13 *OAIL* at 10.

14 *See id.* at 12; *see also id.* at 10 ("[W]e are resting our detention authority on . . . . [the] AUMF.").

15 *See id.* at 10 ("[W]e continue to fight a war of self-defense."); *id.* at 12 ("[T]he United States . . . may use force [against al Qaeda and Taliban] consistent with its inherent right to self-defense.").

16 *See* Legal Consequences of the Construction of a Wall in Occupied Palestinian Territory, Advisory Opinion*,* 2004 I.C.J. 136 (July 9); Armed Activities on the Territory of the Congo (Dem. Rep. Congo v. Uganda), 2005 I.C.J. 168 (Dec. 19); *see also Congo v. Uganda*, Separate Opinion of Simma, J., at 3-4, ¶¶ 10-15. For criticism, *see, e.g.,* Gregory E. Maggs, *The Campaign to Restrict the Right to Respond to Terrorist Attacks in Self-Defense Under Article 51 of the U.N. Charter and What the United States Can Do About It,* 4 Regent J. Int'l L. 149 (2006); Sean Murphy, *Self-Defense and the Israeli Wall Advisory Opinion: An Ipse Dixit From the ICJ?*, 99 Am. J. Int'l L. 62 (2005); Michla Pomerance, *The ICJ's Advisory Jurisdiction and the Crumbling Wall between the Political and the Judicial,* 99 Am. J. Int'l L. 26 (2005).

17 Geneva Convention Relative to the Treatment of Prisoners of War, 6

U.S.T. 3316. Signed Aug. 12, 1948, entered into force Oct. 21, 1950.

18 Geneva Convention Relative to the Protection of Civilian Persons in Time of War, 6 U.S.T. 3516. Signed Aug. 12, 1948, entered into force Oct. 21, 1950.

19 Protocol Additional to the Geneva Conventions of 12 August 1949, and Relating to the Protection of Victims of International Armed Conflict, 16 I.L.M. 1391 (1977).

20 Michael J. Matheson, *Continuity and Change in the Law of War: 1975 to 2005: Detainees and POWs,* 38 Geo. Wash. Int'l L. Rev. 543, 545 (2006). Mr. Matheson writes with particular authority as a former Principal Deputy Legal Adviser to the State Department. Further background for the U.S. decision not to ratify API may be found in *Letter of Transmittal from President Reagan, to the U.S. Senate, Agora: The U.S. Decision Not to Ratify Protocol I to the Geneva Conventions on the Protection of War Victims,* 81 Am. J. Int'l L. 910 (1987); Abraham D. Sofaer, *The Rationale for the U.S. Decision,* 82 Am. J. Int'l L. 784 (1988).

21 *See* Michael J. Matheson, *The United States Position on the Relation of Customary International Law to the 1977 Protocols Additional to the 1949 Geneva Conventions,* 2 Am. U.J. Int'l L. & Pol'y 419 (1987).

22 W. Michael Reisman, *Holding the Center of the Law of Armed Conflict,* 100 Am. J. Int'l L. 852, 856 (2006).

23 *OAIL* at 12 (following AP I art. 51(2)).

24 *Id*. (following AP I art. 51(5)(b)).

25 The classic description of this category of combatants, written close in time to the drafting of the 1949 Geneva Conventions, is R.R. Baxter, *So-Called "Unprivileged Belligerency": Spies, Guerrillas, and Saboteurs,* 28 Brit. Y.B. Int'l L. 323 (1952). A State Department Legal Adviser in the Bush Administration also explained and justified the distinction between two categories of combatants. *See* William H. Taft, IV, *The Law of Armed Conflict After 9/11: Some Salient Features,* 28 Yale J. Int'l L. 319, 320-21 (2003).

26 It has been accepted on all sides since the Supreme Court's ruling in *Hamdan v. Rumsfeld,* 548 U.S. 557, 630-31 (2006), that the protections afforded to combatants in a non-international conflict under "common" Article 3 of the POW Convention applies in the current conflict with al Qaeda and Taliban. The Bush Defense Department ordered the Court's ruling to be implemented soon after it came down. *See* Office of the Secretary of Defense, Memorandum for Secretaries of the Military Departments (July 7, 2006) (quoted in part in Robert J. Delahunty, *Is the Geneva Convention 'Quaint'?*, 33 Wm. Mitchell L. Rev. 1635, 1649 n.47 (2007)).

27 *See, e.g.,* Knut Dörmann, *The Legal Situation of "Unlawful/Unprivileged Combatants,"* 85 Int'l Rev. Red Cross 45 (2003).

28 *See, e.g.,* Gerry Simpson, Law, War & Crime 176-77 (2007).

29 Harold Hongju Koh, *On America's Double Standard: The Good and Bad Faces of Exceptionalism,* Am. Prospect (Sept. 20, 2004), *available at* http://www.prospect.org/cs/articles?article=on_americas_double_ standard.

30 For a superb recent review of the legal issues, *see* Curtis A. Bradley, *The United States, Israel & Unlawful Combatants,* 12 Green Bag 2d 271 (2009).

31 Robert F. Turner, *Civilian Terror Trials Are the Violation,* N.Y. Post, May 4, 2010, *available at* http://www.nypost.com/p/news/opinion/opedcolumnists/civilian_terror_trials_are_the_violation_irA81LHSMcsL1gVEw6OtRM.

32 *See United States to Prosecute Five Guantanamo Detainees in Federal Courts and Five Before Military Commissions, Use of Federal Courts Draws Criticism,* 104 Am. J. Int'l l. 112 (2010).

33 *OAIL* at 11 (emphasis added). In both Administrations, however, provisions have been made for individualized determinations of dangerousness, permitting the release of some detainees. *See* Bradley, *supra* note 30, at 284.

34 As Professor Bradley notes, the Obama Administration has also argued in court that it is entitled under international law to treat al Qaeda members as combatants rather than as civilians. Bradley, *supra* note 30.

35 *OAIL* at 12.

36 *Id.* at 11.

37 The courts apparently do not share Koh's reluctance to use the term. *See Faim al Maqaleh v. Gates,* No. 09-5265, D.C. Cir. (May 21, 2010), slip op. at 3 ("All three petitioners are being held as unlawful enemy combatants . . . in Afghanistan").

38 *See* Charlie Savage, *Detainees Will Still Be Held, but Not Tried, Official Says,* N.Y. Times, Jan. 22, 2010, *available at* http://www.nytimes.com/2010/01/22/us/22gitmo.html.

39 *See* Civilian Convention arts. 42, 132; *see also id.* art. 78; Bradley, *supra* note 30, at 273.

40 *See* Warren Richey, *Holder: 'Failure Not an Option' in New York 9/11 Terror Trial*, Christian Sci. Monitor, Nov. 19, 2009, *available at* http://www.csmonitor.com/USA/Justice/2009/1119/p02s13-usju.html ("Holder was repeatedly questioned about the prospect of an acquittal. He was reluctant throughout much of the hearing to say so, but ultimately he acknowledged that in the event of an acquittal in a terror trial the administration might consider shifting a defendant back from the criminal justice system into open-ended military detention. 'Under the regime we are contemplating. . . the ability to detain under laws of war, we would retain that ability,' Holder said.").

41 This follows directly from the "principle of distinction," discussed above.

42 Even Philip Alston, the Special Rapporteur for the United Nations Human Rights Council (UNHRC), concedes that "there is no commonly accepted definition of [direct participation in hostilities. . . . [T]here is dispute over the kind of conduct that constitutes 'direct participation' and makes an individual subject to attack." *Report of the Special Rapporteur on extrajudicial, summary or arbitrary executions, Philip Alston*, U.N. General Assembly Doc. A/HRC/14/24/Add.6 at 19 (May 28, 2010)(UNHRC Report). Other legal scholars agree. "There is little guidance on what the words 'direct participation' mean and on when a person is to be considered as no longer taking a direct part in hostilities so that he again benefits from civilian immunity." Dapo Akande, *Clearing the Fog of War? The ICRC's Interpretive Guidance on Direct Participation in Hostilities* (June 4, 2009), *available at* http://www.ejiltalk.org/clearing-the-fog-of-war-the-icrcs-interpretive-guidance-on-direct-participation-in-hostilities/.

43 Additional Protocol I, art. 51(3) (emphasis added).

44 *See* HCJ 769/02 *Public Comm. Against Torture in Israel v. Gov't of Israel* [2006], *available at* http://elyon1.court.gov.il/Files_ENG/02/690/007/a34/02007690. a34.pdf...

45 *See* Interpretive Guidance on the Notion of Direct Participation in Hostilities Under International Humanitarian Law (International Committee of the Red Cross) (Feb. 26, 2009), *available at* http://www.icrc.org/Web/eng/siteeng0.nsf/htmlall/review-872-p991/$File/irrc-872-reports-documents.pdf.

46 *OAIL* at 11.

47 The UNHRC Special Rapporteur has also underscored this point. "[A]lthough the US has not made public its definition of DPH [direct participation in hostilities], it is clear that it is more expansive than that set out by the ICRC." UNHRC Report at 21.

48 Akande, *supra* note 42.

49 *Interpretive Guidance, supra* note 45, at 56.

50 U.S. Senate Foreign Relations Committee, Afghanistan's Narco War: Breaking the Link Between Drug Traffickers and Insurgents: Report to the Senate Committee on Foreign Relations, S. Rep. No. 111-29, at 15-16 (2009).

51 The UNHRC Report criticizes Koh on this very point. *See* UNHRC Report at 21.

52 Brief of Louis Henkin, Harold Hingju Koh, and Michael H. Posner as *Amici Curiae* in Support of Respondents, *Rumsfeld v. Padilla,* Sup. Ct. No. 03-1027 (Apr. 12, 2004) (*Padilla* Brief).

53 *Padilla* Brief at 20-1.

54 *Id.* at 19.

55 *Id.* at 23.

56 *Id.* at 21.

57 Padilla was convicted in 2007 on three terrorism-related charges, and his conviction is on appeal. "The key piece of physical evidence against Padilla was a 'mujahideen data form' – basically, a personnel form that a CIA witness testified had been recovered from an al-Qaeda camp in Afghanistan. Although

defense lawyers attacked its authenticity, it bore Padilla's fingerprints and some of his personal information." Peter Whoriskey, *Jury Convicts Jose Padilla of Terror Charges: Two Co-Defendants Also Found Guilty,* The Washington Post (Aug. 17, 2007), available at http://www.washingtonpost.com/wp-dyn/content/article/2007/08/16/ AR2007081601009.html.

58 *Padilla* Brief at 25.

59 OAIL at 11.

60 As the strategic analyst Andrew Bacevich has written, drone missiles have become President Obama's "weapon of choice for an expanded Israeli-style program of targeted assassination in Pakistan." Andrew J. Bacevich, Op-Ed, *Obama's Sins of Omission*, Boston Globe, Apr. 25, 2009, *available at* http://www.boston.com/bostonglobe/editorial_opinion/oped/articles/2009/04/25/obamas_sins_of_omission/.

> On a typical day, there are roughly a half-dozen Predators in the air over the tribal areas of western Pakistan, looking for targets. . . . This intensive coverage is possible because the Obama CIA requested more resources for the drone attacks last March. . . . By the end of [2010], the number of drones available will have increased by about 40 percent since early 2009.

David Ignatius, *Terrorists in the Cross Hairs* (Feb. 17, 2010), available at http://www.realclearpolitics.com/articles/2010/02/17/terrorists_in_the_cross_hairs_104435.html.

61 CNN.com, *U.S. airstrikes in Pakistan called 'very effective,'* May 18, 2009, available at http://www.cnn.com/2009/POLITICS/05/18/cia.pakistan.airstrikes/.

62 *See United States Continues Attacks on Suspected Terrorists in Yemen, Pakistan,* 104 Am. J. Int'l L. 133 (2010).

63 *See* Peter Bergen & Katherine Tiedemann, *No Secrets in the Sky,* N.Y. Times (Apr. 25, 2010), *available at* http://www.nytimes.com/2010/04/26/opinion/26bergen.html; David Ignatius, *Revenge On the Taliban, From 10,000 Feet* (Feb. 4, 2010), *available at* http://www.washingtonpost.com/wp-dyn/content/article/2010/02/02/ AR2010020203514.html ("Although Pakistan publicly criticizes the drone attacks, [an unnamed] administration official stressed that the recent campaign 'is being done in full concert and cooperation' with the Pakistani government."). .

64 '*American Drone Attacks Are Counterproductive*,' Der Spiegel Online International (Dec. 1, 2009), *available at* http://www.spiegel.de/international/world/0,1518,664328,00.html.

65 Mary Ellen O'Connell , *Lawful Use of Combat Drones,* Congress of the United States, House of Representatives, Subcomm. on National Security and Foreign Affairs, Hearing: Rise of the Drones II: Examining the Legality of Unmanned Targeting at 3 (Apr. 28, 2010). The argument is that Pakistan could not legitimately consent to the unlawful killing either of its own nationals or of others on its territory.

66 *Cf. The Corfu Channel Case (U.K. v. Albania),* Merits, [1949] ICJ Rep. 4, 35 (April 9); *id..,* Separate Opinion of Alvarez, J., at 47.

67 *See Corfu Channel Case, supra* note 66*,* Separate Opinion of Alvarez, J. at 41.

68 For discussion and evaluation of the Coalition's interpretation of S.C. Res. 688, see John F. Murphy, The United States and the Rule of Law in International Affairs 151 -52 (2004). S.C. Res. 688 was not enacted as a Chapter VII measure.

69 Indeed, even after Kosovo's declaration of independence in February, 2008, NATO took the position that S.C. Res. 1244 authorized the continuing presence of its forces in Kosovo. *See NATO's role in Kosovo, available at* http://www.nato.int/cps/en/natolive/topics __48818.htm; *see also* Robert J. Delahunty & Antonio F. Perez, *The Kosovo Crisis: A Dostoievskian Dialogue on International Law, Statecraft, and Soulcraft,* 42 Vand. J. Transnat'l L. 15, 88-89 (2009).

70 *See* Legal Consequences for States of the Continued Presence of South Africa in Namibia Notwithstanding Security Council Resolution 276 (1970), Advisory Opinion, 1971 ICJ Rep. 16, 294 at ¶ 115(June 21) (Fitzmaurice, J., dissenting) ("*Even when acting under Chapter VII of the Charter itsel*f, the Security Council has no power to abrogate or alter territorial rights, whether of sovereignty or administration.") (original emphasis).

71 For a penetrating analysis, *see* Sean D. Murphy, *The International Legality of US Military Cross-Border Operations from Afghanistan into Pakistan*, Michael N. Schmitt (ed.), *The War in Afghanistan: A Legal Analysis*, 85 Int'l L. Stud. 109, 120-22 (Naval War College 2009).

72 *See* Timothy S. Lynch & Robert S. Singh, After Bush: The Case for Continuity in American Foreign Policy 136 (2008).

73 Koh asserts that the proportionality test is "implemented rigorously throughout the planning and execution of lethal operations," *OAIL* at 13, which leaves open the question of the specific level of its application. That question is important, however, in light of the "cumulative effects" test developed in the law of war jurisprudence of the International Criminal Tribunal for the Former Yugoslavia. *See* Prosecutor v. Kupresic*,* Case No. IT-95-16 at ¶ 526, Judgment of Jan. 14, 2000 (Trial Chamber) ("[I]t may happen that single attacks on military objectives causing incidental damage to civilians, although they may raise doubts as to their lawfulness, nevertheless do not appear on their face to fall foul *per se* of the loose prescriptions of [AP I] Articles 57 and 58 (or of the corresponding customary rules). However, in case of repeated attacks, all or most of them falling within the grey area between indisputable legality and unlawfulness, it might be warranted to conclude that the cumulative effect of such acts entails that they may not be in keeping with international law. Indeed, this pattern of military conduct may turn out to jeopardize excessively the lives and assets of civilians, contrary to the demands of humanity.").

74 *See* Bergen & Tiedemann, *supra* note 63 (estimating that since January 2009, U.S. strikes in Pakistan have killed 520 people, of whom 410 were militants, and suggesting that civilian casualties might be significantly lower than that). The figures are, however, disputed, by Amnesty International among others. *See* Scott Shane, *C.I.A. to Expand Use of Drones in Pakistan,* N.Y. Times, Dec. 4, 2009, *available at* http://www.nytimes.com/2009/12/04/worl/asia/04-drones.html?. In general, however, U.S. forces operating in Afghanistan appear to have adopted rules of engagement that are highly protective of civilians. *See* Robert Burns & Anne Flaherty, US War Aim: Protect Civilians First, the Troops (May 13, 2010), *available at* http://www.realclearpolitics.com/news/ap/politics/2010/May/13/us_war_aim__protect_civilians_first__then_troops.html.

75 *'The Soldiers Call It War Porn.'* Interview with U.S. defense expert P.W. Singer, Der Spiegel Online International (Mar. 12, 2010), *available at* http://www.spiegel.de/international/world/0,1518,682852,00.html. *See generally* P.W. Singer, *Wired for War: The Robotics Revolution and Conflict in the 21st Century* 33-36 (2009).

76 *See* Shane, *supra* note 74. On the other hand, residents of the tribal areas where the drone attacks occur, who suffer under the rule of local militants, are reported to be much less critical of the drone program. *See id.* .

77 *See* Human Rights Watch, Pakistan: Taliban, Army Must Minimize Harm to Civilians (May 18, 2009), *available at* http://www.hrw.org/en/news/2009/05/18/pakistan-taliban-army-must-minimize-harm-civilians.

78 *See* Michael L. Gross, Moral Dilemmas of Modern War: Torture, Assassination, and Blackmail in an Age of Asymmetric Conflict 109, 112-13 (2010).

79 *See* Marc A. Thiessen, *Dead Terrorists Tell No Tales: Is Barack Obama Killing Too Many Bad Guys Before the US Can Interrogate Them?*, Foreign Pol'y (Feb. 8, 2010), *available at* http://www.foreignpolicy.com/articles/2010/02/08/dead_terrorists_tell_no_tales.

80 *See* Mark Mazzetti & Scott Shane, *Evidence Mounts for Taliban Role in Bomb Plot,* N.Y. Times, May 5, 2010, , *available at* http://www.nytimes.com/2010/05/06/nyregion/06bomb.html ("There is no doubt among intelligence officials that the barrage of attacks by the C.I.A. drones over the past year has made Pakistan's Taliban. . . . increasingly determined to seek revenge by finding any way possible to strike at the United States. . . . [N]ow possibly the failed S.U.V. attack in Manhattan [is a] reminder[] that the drones' very success may be provoking a costly response.").

81 The Associated Press, *Holder: Pakistani Taliban Behind Times Square Plot, Holder Says*, May 9, 2010, *available at* http://www.npr.org/templates/story/story.php?storyId=126559055.

82 *OAIL* at 13 (original emphasis).

83 The United Nations Special Rapporteur on Extrajudicial, Summary or Arbitrary Executions took the position that such attacks constituted clear

cases of extrajudicial killing. The United States, in reply, maintained that the International Covenant on Civil and Political Rights had no application to the incident, on the grounds that "[t]he conduct of a government in legitimate military operations, whether against al Qaida operatives or any other legitimate military target, would be governed by the international law of armed conflict," rather than by international human rights law. *See* U.N. Econ. & Soc. Council [ECOSOC], Comm'n on Human Rights, *Report of the Special Rapporteur on Extrajudicial, Summary or Arbitrary Executions*, ¶ ¶ 611–12, U.N. Doc. E/CN.4/2004/7/Add.1 (Mar. 24, 2004). It would have been more accurate for the U.S. to have described the conflict as "non-international."

84 *See* Gross, *supra* note 78, at 118 (arguing that "naming" un-uniformed targets redresses the unfairness of the unequal risks otherwise assumed by uniformed combatants). For a defense of the legality of the drone program against the charge that it violates international human rights law, see Robert J. Delahunty & John C. Yoo, *What is the Role of International Human Rights Law in the War on Terror?,* 59 DePaul L. Rev. 301 (2010).

85 *See U.S. Defends Legality of Killing With Drones,* WSJ.com (April 5, 2010), *available at*http://online.wsj.com/article/SB100014240527023034507045 75159864237752180.html. .

86 *Id.*

87 UNHRC Report at 22 (emphasis added).

88 *See* Greg Miller, *Obama Preserves Renditions as Counter-Terrorism Tool,* L.A. Times (Feb. 1, 2009), *available at* http://articles.latimes.com/2009/feb/01/nation/na-rendition1.

Labor & Employment Law

Does the First Amendment Allow States to Compel Recipients of Government Monies to Support State-Designated Representatives?

*By William L. Messenger**

A basic precept of democracy is that citizens choose their representatives in government. A growing trend in several states raises a new question: can governments choose representatives for their citizens?

Increasing numbers of states are designating entities to act as the mandatory representatives of groups of citizens vis-à-vis state agencies with respect to government programs that affect those citizens. The state-designated representatives are granted exclusive privileges to speak with state agencies to influence their administration of the government programs, and the citizens are compelled to pay for this compulsory representation.

These state schemes are currently directed at self-employed individuals who provide care to participants in state Medicaid and childcare programs ("providers"). However, if those schemes are lawful, any group of individuals or entities affected by a government program could be required to support a state-designated representative.

States compelling citizens to support an entity for the purpose of speaking to the state raises profound constitutional issues. Specifically, does this infringe upon the freedom of citizens to associate for purposes of speech and petition the government for redress of grievances under the First Amendment? Two lawsuits—*Schlaud v. Granholm* in Michigan and *Harris v. Quinn* in Illinois—present these issues to the federal courts.[1]

Personal Care and Childcare Providers

Two principal groups of individuals are currently being subjected to state-imposed representation. The first group is "Personal Care Providers," who provide home personal care to disabled, chronically ill, or elderly individuals whose care is paid for by state self-directed home and community-based service ("HCBS") programs established under Medicaid. This care generally includes assistance with daily living activities, such as dressing, grooming, and homemaking. Although the details of state HCBS programs vary, their core feature is that participants have discretion to hire, fire, and supervise their Personal Care Providers. The state subsidizes participants' costs for hiring a Personal Care Provider and provides counseling to facilitate the process.[2]

For example, the Illinois HCBS programs at issue in *Harris* subsidize the costs of home-based services for disabled individuals up to certain statutory maximums.[3] Program participants may use their allotted subsidy to employ Personal Care Providers, whom they choose, hire, fire, and supervise. The state pays these providers a certain hourly rate, which counts against the participants' subsidy.

The second group is "Childcare Providers," who provide home childcare (i.e., daycare) services to parents whose childcare expenses are subsidized by state programs established under the federal Child Care and Development Fund (CCDF).[4] Childcare Providers include independent contractors who operate daycare businesses from their homes, employees employed in parents' homes, and relatives willing to watch their grandchildren or other related children in their homes.[5] State programs generally permit participants to hire the private Childcare Provider of their choice,[6] with the state's role generally limited to paying some or all of their childcare costs.[7]

For example, the Michigan childcare program at issue in *Schlaud* pays between $1.60 and $3.60 of the hourly childcare expenses of qualified low-income individuals.[8] Program participants may choose any qualified private childcare provider of their choice, but are liable for paying any amount of their childcare providers' fee that exceeds the state subsidy.

The common relevant feature of Personal Care and Childcare Providers is that they are individuals who provide services that are paid for, in whole or in part, by state subsidy programs. But, they are not employed by states. Rather, they are private independent contractors or employees of the individuals that hire them.

State-Designated Representation

At least seventeen states have laws or executive orders that permit the designation of mandatory representatives for Personal Care and/or Childcare Providers: California, Illinois, Iowa, Kansas, Maine, Maryland, Massachusetts, Michigan, Missouri, New Mexico, New York, Ohio, Oregon, Pennsylvania, Washington, and Wisconsin.[9] The specifics of the schemes vary by state. Some are state statutes, while others are unilateral actions by state Governors. However, the schemes do share common features:

- An entity is designated by the state as the representative of providers for the purpose of speaking with a specific state body, usually pursuant to a mail-ballot election. The state bodies include Governors' offices, particular agencies, and often special "councils" created for the purpose of dealing with a provider representative.
- The purpose for the representation is to influence how the state administers aspects of a public aid program that affects the providers. This is generally limited to monies or benefits provided for serving participants in the programs.
- The state body is obliged to meet and deal with the representative on this issue, with the objective being to reach an agreement that governs what the state body will attempt

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to do with respect to the program. However, the state body often lacks the power to actually implement the agreement, as changes to public programs and subsidy rates often require rulemaking and/or legislation.

- The agreements between the state body and representative require that all providers pay fees to the representative, which are generally deducted directly from the monies owed to providers for caring for participants in state HCBS and childcare programs. The exception is in schemes implemented by executive order in states with statutes that prohibit compulsory deduction of monies from individuals, such as Right to Work states Iowa and Kansas.

- The state-designated representatives have all been unions, usually affiliates of the Service Employees International Union ("SEIU") or American Federation of State, County, and Municipal Employees ("AFSCME"). The schemes have been implemented under administrations politically supported by these unions.

Another common feature is that all state schemes use labor law terminology, such as "exclusive representation" and "collective bargaining." Indeed, some state schemes define providers as "public employees" solely for purposes of a public sector-bargaining statute, but for no other purpose.[10]

This terminology does not address the fact that not only are providers not employed by the states—at most some could be considered government contractors—but states are actually designating mandatory lobbyists for their citizens.

Consider the situation at its most basic level. Providers are simply a group of citizens who receive monies from a government program. They are similar to many other groups in this respect: public-aid recipients, contractors with government, financial institutions, automobile companies, and others. States are compelling this particular group of citizens to support an entity for the purposes of speaking with state bodies to influence the administration of the government program that affects them. This activity is commonly referred to as "lobbying"[11]—or "petition[ing] the Government for a redress of grievances," in the parlance of the First Amendment.

Properly understood, at issue is nothing short of compulsory political representation. The representation imposed upon providers is no different from the government designating the American Association of Retired Persons as the mandatory representative of all senior citizens on Medicare; ACORN as compulsory voice of all individuals who receive government-subsidized housing; or the American Banking Association as the mandatory trade association for all financial institutions receiving Troubled Asset Relief Program funds, and then forcing the members of each group to pay monies to these organizations to lobby the government for more monies and benefits from these programs.

Constitutional Challenge

The First Amendment guarantees a right to "freedom of speech" and "to petition the Government for a redress of grievances." Implicit within these rights is the freedom to associate, or not associate, for the purposes of speaking and lobbying the government.[12] Whether compelling providers to support a state-designated representative for purposes of speaking to and petitioning the state violates these constitutional rights is the issue currently before the federal courts in two cases: *Schlaud v. Granholm* and *Harris v. Quinn*.[13]

Schlaud is a class-action lawsuit filed for over 40,000 Michigan Childcare Providers in the U.S. District Court for the Western District of Michigan in February 2010.[14] These providers include independent contractors who operate small daycare businesses from their homes; employees of parents in the homes of children; and relatives who watch their grandchildren or other related children in their homes. Many of these providers receive $1.60 to $3.60 per hour from a Michigan program for caring for the children of low-income parents (parents must pay the remainder).

Michigan Childcare Providers are being compelled to pay monies to a joint venture of the United Auto Workers (UAW) and AFSCME as a condition of doing business with state-subsidized parents. Michigan Governor Granholm's administration designated the UAW/AFSCME union as the representative of all Childcare Providers for the purposes of dealing with an advisory council (the "Michigan Home Based Child Care Council") created for the purpose of dealing with that union. The union and council entered into an agreement whose only non-precatory term is a requirement that all Childcare Providers pay a "service fee" to the UAW/AFSCME union for representing their interests before this advisory council.[15]

Harris is a lawsuit filed by two groups of Personal Care Providers in the District Court for the Northern District of Illinois in April 2010.[16] Both groups are employed by disabled individuals whose care is subsidized by one of two Illinois HCBS programs. Under former Illinois Governor Blagojevich, the state designated one group of providers as "public employees," and the State of Illinois as their "employer," solely for the purposes of the Illinois Public Labor Relations Act, and no other purpose.[17] An SEIU local was then designated as the representative of the providers. It entered into an agreement with the state that compels approximately 20,000 providers to pay millions of dollars in fees to the SEIU each year. Current Illinois Governor Quinn is attempting to force a second group of Personal Care Providers into the SEIU by means of an executive order.[18]

The complaints in both *Schlaud* and *Harris* allege that compelling providers to support a state-designated representative as a condition of receiving public monies infringes on their First Amendment rights, in violation of the Fourteenth Amendment and 42 U.S.C. § 1983. Specifically, it is alleged that providers are being forced to support core First Amendment activities, namely "speech" directed to the government and "petition[ing] the Government for a redress of grievances." It is further alleged that no government interest justifies this infringement on the providers' constitutional rights. These cases are pending before the district courts at the time of this article.

Vital Government Interest?

The dispositive issue in *Harris, Schlaud*, and any similar case filed in the future is whether a narrowly-tailored, vital government interest exists for compelling providers to support a state-designated representative. It is well-established that

compelling individuals to associate with an entity as a condition of receiving a public benefit infringes upon First Amendment rights.[19] Such infringements must survive exacting scrutiny, which requires that the state action be "narrowly tailored to further vital government interests."[20]

Whether a vital government interest justifies the compulsory representation imposed upon providers is an open question. Not only have the federal courts not addressed it any published decision,[21] but the interests found to justify compelled association in other contexts are inapplicable. For example, the "confidential employee" interest recognized by the Supreme Court in its political patronage precedents (*Elrod* and *Branti*)[22] has no relevance to providers. The "labor peace" interest held to partially justify compulsory unionism in employer/employee relations in *Street* and *Abood* is inapplicable to private citizens who are not in an employer/employee relationship, but are independent contractors who work for themselves in their own homes or homes of their customers.[23]

The interest most states assert for compelled representation is an ostensible need for provider input. Specifically, the asserted rationale is that provider input will improve the state's administration of the public aid program—sometimes by facilitating greater benefits for providers—and that collective representation is required because providers lack an effective means of communicating their views to the state.[24]

This rationale has several apparent flaws. It is counter-intuitive that only listening to one entity (the union), but not providers themselves, will increase provider input. Moreover, states can unilaterally provide more monies or benefits to providers, or ascertain the views of a union or providers themselves regarding this issue, without forcing all providers to support a union.

Most troubling are the implications of the asserted interest: that a state can designate a compulsory voice for citizens if it deems that they do not adequately voice their views voluntarily. This purports a state interest in dictating the degree to which individuals should engage in core First Amendment activities. It also assumes a state interest in dictating how much political influence particular groups of citizens should wield. If this is accepted as a legitimate state interest by the courts, matters once exclusively reserved to individual choice under the First Amendment—choosing whether and how to speak to and petition the government for a redress of grievances—will be subject to the tyranny of the majority.

Limitless Application

The ultimate outcome of *Schlaud*, *Harris*, and any similar future cases will have far-reaching effects. If the courts hold it unconstitutional to compel providers to support an entity for the purposes of speaking to and petitioning the state, union schemes in more than seventeen states could be invalidated. Hundreds of thousands of individuals would no longer be required to pay monies to state-designated political representatives as a condition for caring for individuals whose care the state subsidizes.

On the other hand, if it is held constitutional to compel providers to support state-designated lobbying representatives, states and Congress will be free to impose similar types of representation on other groups. This most evidently would include any individuals that receive monies from a government program, such as contractors with the government and recipients of Medicaid, Medicare, food stamps, subsidized housing, and other government entitlements. All of those individuals have as much interest as providers, if not more, in the government programs in which they participate. States, or Congress, could equally assert that greater input from these individuals could result in more benefits for them or improve the government programs. If Personal Care Providers who care for Medicaid patients can be compelled to support a union as their representative with respect to state Medicaid policies, Medicaid patients themselves can be similarly compelled.

Indeed, there is no reason why only recipients of government monies could be subjected to compulsory representation; it could be any occupation or enterprise regulated by the state or federal government. Nor is there any reason why only unions could be appointed as representatives; it could be a trade association or any other special-interest group. For example, a government that can lawfully make a union the mandatory representative of home Childcare Providers can lawfully make a trade association the mandatory representative of all corporate daycare centers regulated by that government.

Government designation of compulsory representatives for citizens has consequences for the democratic process. This might be viewed by some critics as the diversion of public monies to political special-interest groups. In many ways, these representation schemes conjure a similar image to political patronage systems held unconstitutional in the 1970's, in which individuals were required to support a political party to receive public benefits.[25]

On a higher level, state-designated representation alters the fundamentals of the political process by granting government officials the ability to artificially empower special-interest groups to support their agendas. An advocacy group that individuals must support financially as a condition of receiving public benefits, and that enjoys special privileges in lobbying the state, will naturally have resources that far exceed what citizens would provide to it voluntarily. Thus, that group will wield political influence that exceeds citizens' voluntary support for the group and its agenda. This necessarily distorts the "market place" of competing ideas upon which the democratic process is predicated.

In Federalist No. 10, James Madison warned of the dangers posed to democratic governance by "factions" of individuals united for narrow, rent-seeking purposes.[26] A compulsory faction, artificially created by the state for the very purpose of advocating for a defined group of citizens on a discrete issue, raises this danger to a new level.

CONCLUSION

The government dictating who represents and advocates for groups of citizens on matters of public policy raises profound issues for the First Amendment and the democratic process. These issues are before the federal courts in *Harris* and *Schlaud*. The outcome of these and similar cases could define (or redefine) the proper relationship between citizens and government.

Endnotes

1 Schlaud v. Granholm, Case No. 1:10-cv-147 (W.D. Mich); Harris v. Quinn, Case No. 1:10-cv-02477 (N.D. Ill.). The author is attorney for the plaintiffs in these cases.

2 *See, e.g.*, Janet O'Keefe et al., Robert E. Johnson Foundation, Developing and Implementing Self-Direction Programs and Policies: A Handbook (2007); J.R. Knickman & R.I. Stone, *The Public/Private Partnership Behind the Cash and Counseling Demonstration and Evaluation: Its Origins, Challenges, and Unresolved Issues*, 42 Health Serv. Res. 362 (2007); B.C. Spillman, K.J. Black & B.A. Ormond, Henry J. Kaiser Foundation Commission on Medicaid and the Uninsured, Beyond Cash and Counseling: The Second Generation of Individual Budget-based Community Long Term Care Programs for the Elderly (2007).

3 Home Services Program, 20 Ill. Comp. Stat. 2405/1 *et seq.*, 89 Ill. Admin. Code §§ 676 *et seq.*; Home Based Support Services Program, 405 Ill. Comp. Stat. 80/20-1 *et seq.*; 59 Ill. Admin. Code §§ 117 *et seq.*

4 Child Care and Development Block Grant Act of 1990, 42 U.S.C. § 9858 *et seq.*; *see also* 45 C.F.R. §§ 98.1 *et seq.* (implementing regulations).

5 "Eligible child care provider [under the CCDF] means: (1) A center-based child care provider, a group home child care provider, a family child care provider, an in-home child care provider, or other provider of child care services for compensation . . ." 45 C.F.R. § 98.2. "Group home" and "family child care" are defined as those that provide childcare services in their own homes, *id.*, an "in-home child care provider means an individual who provides child care services in the child's own home," *id.*, and "types of providers include . . . relatives who provide care." *Id.*

6 45 C.F.R. § 98.3.

7 Note that operation of home childcare businesses often requires a state license. However, these regulations are usually of general application—applicable to all childcare providers irrespective of whether they serve subsidized children—and are usually not the subjects of the compelled representation to which Childcare Providers are subject.

8 Child Development and Care Program, Mich. Comp. Laws § 400.6; Mich. Admin. Code r 400.5001 *et. seq.*; MI. Pub. Act No. 129, § 675.3(a)(ii) (30 Oct 2009) (setting subsidy rate).

9 Cal. Welf. & Inst. Code, § 12301.6(c)(1); 20 Ill. Comp. Stat. 2405/3(f); IA Executive Order 45 (16 Jan. 2006); KS Exec. Order No. 07-21 (18 July 2007); MD Exec. Order 01.01.2007.14 (6 August 2007); Mass. Gen. Laws Ch. 118G, § 31(b); Interlocal Agreement Between Mich. Dept. of Human Services and Mott Comm. College, § 6.10 (27 July 2006) (on file with author); Minnesota is by county; Mo. Rev. Stat. § 208.862(3); Montana; N.M. Stat. § 50-4-33; NY Exec. Order No. 12 (11 May 2007); NJ Exec. Order 23 (2 August 2006); OH Exec. Order 2007-23S (17 July 2007) & OH Exec. Order 2008-02S (1 Feb. 2008); Or. Const. art. XV, § 11; Or. Rev. Stat. § 657A.430; PA Exec. Order 2007-06 (14 June 2007); Wash. Rev. Code §§ 41.56.028 and 41.56.029; Wis. Stat. §§ 111.81 *et. seq.*; WI Exec. Order 172 (16 Nov. 2006). Several counties in Minnesota have also recognized union representatives of childcare providers.

10 Cal. Welf. & Inst. Code, § 12301.6(c)(1); 20 Ill. Comp. Stat. 2405/3(f); Mass. Gen. Laws Ch. 118G, § 31(b); Mo. Rev. Stat. § 208.862(3); Or. Rev. Stat. § 657A.430(3); Wis. Stat. §§ 111.81 *et. seq.*

11 *Cf.* 2 U.S.C. § 1607(a) (defining "lobbying contact" under Federal Lobbying Disclosure Act).

12 *See, e.g.,* Elrod v. Burns, 427 U.S. 347, 356-57 (1976); Roberts v. U.S. Jaycees, 468 U.S. 609, 623 (1984).

13 *See supra* note 1.

14 Complaint is available online at www.nrtw.org.

15 Agreement Between Michigan Home Based Child Care Council and Child-care Providers Together Michigan is Exhibit B to the Complaint in Schlaud, and is available online at www.nrtw.org.

16 Complaint is available online at www.nrtw.org.

17 20 Ill. Comp. Stat. 2405/3(f); *see also* Ill. Executive Orders 2003-08 (7 March 2003).

18 Ill. Executive Order 2009-15 (29 June 2009).

19 *See, e.g.*, Elrod v. Burns, 427 U.S. 347, 359-60 (1976); Branti v. Finkel, 445 U.S. 507 (1980); Rutan v. Republican Party of Ill., 497 U.S. 62 (1990).

20 *See Elrod*, 427 U.S. at 362-63; *Rutan*, 497 U.S. at 72.

21 This issue was one of several counts raised in *West v. SEIU Local 434B*, Case No. 1-CV-10862 (CD. Cal. 2001). However, in an unpublished opinion, the U.S. District Court for the Central District of California dismissed the count on the grounds that "rational basis" scrutiny applied because collective bargaining had been held to be justified by the government's interest in industrial peace in the context of employer/employee relations. *Id.*, slip. op. at 20-23 (Aug. 30, 2002). In the author's opinion, this was not only erroneous, but missed the underlying issue entirely: does a government interest support so-called "collective bargaining" *outside* of an employer/employee relationship?

22 *Elrod*, 427 U.S. 347; *Branti*, 445 U.S. 507.

23 Abood v. Detroit Bd. of Educ., 431 U.S. 209, 233-34 (1977); Int'l Assn' of Machinists v. Street, 367 U.S. 740, 760-64 (1961).

24 Ill. Executive Orders 2003-08 (7 March 2003) and 2009-15 (29 June 2009); Iowa Executive Order 45 (16 Jan. 2006); Maryland Executive Order 01.01.2007.14 (6 August 2007); Mo. Rev. Stat. § 208.853; OH Exec. Order 2007-23S (17 July 2007); OH Exec. Order 2008-02S (1 Feb. 2008); PA Exec. Order 2007-06 (14 June 2007); WI Exec. Order 172 (16 Nov. 2006); *cf.* KS Exec. Order No. 07-21 (18 July 2007); Or. Const. art. XV, § 11.

25 *See Elrod*, 427 U.S. 347; *Branti*, 445 U.S. 507.

26 The Federalist No. 10 (James Madison).

Litigation

Amending the Federal Rules (Again): Finding the Best Path to an Effective Duty to Preserve

*By Thomas Y. Allman**

Implementing a "duty to preserve" can be a complicated and expensive task in a world dominated by discovery of electronically-stored information ("ESI"). As pointed out in one of the papers submitted at the recent 2010 Civil Litigation Conference held at the Duke Law School by the Civil Rules Advisory Committee,[1] "[l]itigants and their lawyers [facing demands for e-discovery] must immediately identify, promptly preserve, comprehensively collect, fairly filter, properly process, rigorously review, and produce ESI in appropriate format[s] without sluggishness, purposeful or otherwise."[2]

Because the sheer volume of information can be staggering, lapses in execution—even with the best of intentions—are inevitable. As a result, the common law historically requires that a potential producing party take timely and reasonable steps to preserve relevant evidence which may be sought in discovery in pending or reasonably-foreseeable litigation.[3]

Currently, litigants are compelled to carry out these tasks while guided by a series of conflicting and potentially inconsistent ad hoc decisions without the guidance of court rules. Sanctions involving e-discovery, predominantly imposed for failures to preserve, but intimately related to production issues as well, can include adverse inference jury instructions, monetary sanctions, or dispositive rulings, often imposed with devastating impact.

This situation persists despite earlier efforts to amend the Federal Rules to incorporate resolution of e-discovery issues. At the 2010 Civil Litigation Conference, a panel of experienced jurists and practitioners (the "Duke E-Discovery Panel")[4] was charged with assessing the efficacy of the e-discovery 2006 Amendments. That panel, including the author, unanimously concluded that amending the Federal Rules to deal with preservation was imperative. This view was supported by statements and surveys demonstrating why the burdens and costs of e-discovery (and preservation) are sapping the competitiveness of our country.

As noted in one paper, "[t]he U.S. Litigation system imposes a much greater cost burden on companies than systems outside the United States [and] [c]lear standards must be included governing the preservation of information even prior to commencement of litigation in order to counteract inconsistent case law on the subject."[5]

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I. A Possible Approach

Drafting an appropriate array of rules to provide meaningful improvement is a challenge. However, the consensus *Elements of a Preservation Rule*[6] as developed by the Panel provides a starting point, as do the preservation guidelines used in the Seventh Circuit E-Discovery Project[7] and the specific proposals submitted by, among others, Lawyers for Civil Justice.[8] The recommendations and conclusions which follow, however, are those of the author alone.

An effective preservation rule should anchor its obligations—whether arising before or after commencement of litigation—to the potential need for relevant evidence in discovery. Doing so should resolve any lingering doubts about the validity of a rule applicable to pre-commencement activity.[9] The focus should be on "reasonableness."[10] Thus, Rule 26 (or Rule 34) could be amended to provide that:

> Parties with actual or constructive notice of the likelihood that relevant and discoverable evidence is or will be sought in discovery shall undertake reasonable and good faith efforts to preserve any such evidence within its possession, custody or control subject to the considerations of Rule 26(b)(2)(C) and Rule 37(e).[11]

In addition, as a subpart of the Rule[12]—or by Committee Note, local rules, or Standing orders—provision should be made to presumptively exempt categories of electronic information or excessive numbers of custodians from the initial preservation scope.

This approach would give "teeth" to early discussion of preservation by forcing requesting parties to surface any unique discovery requirements and thus mitigate the risk of "sandbagging." Many Duke participants also echoed the comment from the ACC General Counsel Survey that "greater court involvement in 'crafting an e-discovery plan [including preservation implications] prior to a dispute would improve the process.'"[13] To date, the early discussion process has been anemic.[14]

In addition, Rule 37 should be amended to supply the necessary guidance for sanctioning preservation failures. The 2006 Amendments began this process in what is now Rule 37(e), at least as to ESI lost as the result of routine, good-faith operations. Thus, Rule 37(b)(2)(a)[15] and Rule 37(c)(1)[16] could be amended to clearly indicate their application to allegations of preservation failure.

Finally, Rule 37(e) could be amended to clarify that losses are sanctionable only if they result from efforts to avoid known preservation obligations and broadened to apply to all forms of routine losses:

> Absent exceptional circumstances, a court may not impose sanctions under these rules on a party for failing to provide

electronically stored information or tangible things lost as a result of the routine, good-faith operation of a system or process in the absence of a showing of intentional or reckless actions designed to avoid known preservation obligations.[17]

Under this approach, Rule 37 would become the principal source of sanctioning authority for all forms of discovery disputes,[18] including preservation failures resulting from pre-litigation conduct. There would rarely be a need to rely on inherent powers since the Rules would be "up to the task."[19]

II. Additional Background & Supporting Remarks

Despite early suggestions by the author[20] and some initial consideration by the Committee of drafting alternatives,[21] there has been a marked reluctance to include preservation obligations in the 2006 Amendments. Instead, the Committee limited itself to enlarging the topics for discussion at the Rule 26(f) conference to include preservation and the addition of (now) Rule 37(e) limiting sanctions for inadvertent loss of ESI due to routine, good faith operations. Committee Notes which "explain[ed] or define[d] a preservation obligation" were withdrawn before the final issuance of the Rules.[22]

Unfortunately, many preservation issues are neither ripe for discussion at the time of the Rule 26(f) conference,[23] nor are counsel prepared or willing to deal with them at that time, for whatever reason. The topic of "retention" was discussed in only about seventeen percent of the cases surveyed in the *FJC National, Case-Based Civil Rules Survey* prepared for the Duke Conference.[24] As a result, potential producing parties often must undertake preservation decisions based solely on assessing the impact of idiosyncratic decisions.

A. Pre-Litigation Conduct

An ongoing concern of the Advisory Committee and the Standing Committee has been the propriety of rulemaking involving conduct prior to the formal institution of litigation.

However, this concern is misplaced. The preservation of evidence for purposes of discovery and trial in distinctly identifiable proceedings is sufficiently "procedural" to pass muster under the Enabling Act.[25] In *Business Guides, Inc. v. Chromatic Communications Enterprises, Inc.*,[26] the Supreme Court upheld Rule 11 over challenge because it had only an incidental impact on substantive rights given its "main objective" to "deter baseless filings and curb abuses."[27] As the Court recently noted in *Shady Grove v. Allstate*,[28] a challenge to a Federal Rule will be rejected when the rule has "regulated only the process for enforcing [parties] rights" and not "the available remedies, or the rules of decision by which the court adjudicated."[29]

Moreover, as Rule 27 demonstrates,[30] and despite dicta to the contrary,[31] activity prior to commencement of an action can be regulated by rulemaking when sufficiently linked to foreseeable litigation. Courts historically and routinely examine (and sanction) pre-litigation conduct which impacts discovery proceedings. In *Silvestri v. General Motors*[32] and in *Goodman v. Praxair Services*,[33] for example, the loss of discoverable evidence at issue occurred long before the lawsuit was filed.

The Supreme Court has acknowledged the force of this logic. In *Chambers v. NASCO,*[34] the majority approved sanctions relating to pre-commencement conduct intimately related to the case.[35]

Finally, the Enabling Act itself provides an opportunity for congressional action which trumps any concerns about the appropriateness or wisdom of such rules. This has already been demonstrated in the pre-litigation context by the limits placed on sanctions in the Private Securities Litigation Act (the "PSLRA").[36]

B. Crafting The Rule-Based Duty to Preserve

An effective rule should articulate a duty to exercise reasonable care under the circumstances, i.e., a "reasonableness standard."[37] This is the strong recommendation of experienced trial practitioners[38] and neutral observers alike. Thus, Principle 5 of The Sedona Principles (2d Ed. 2007) provides that "[t]he obligation to preserve . . . requires reasonable and good faith efforts to retain information that may be relevant to pending or threatened litigation." Some courts prefer to skip this step and simply describe the preservation obligation in mechanistic terms, such as imposing a written litigation hold.[39] Moreover, these "ad hoc judicially created 'litigation hold' procedures [are] created District Court by District Court [and] lack uniformity."[40]

Elevating a written litigation hold to a pre-condition of compliance is inconsistent with a reasonableness standard.[41] A litigation hold is a useful, but not the exclusive, method of compliance.[42] In *Kinnally v. Rogers Corporation,* for example, the "absence of a written litigation hold" was not determinative since the party had taken "appropriate actions to preserve evidence."[43] A better approach would be to provide that if a litigation hold process *is* employed, that fact should be treated as prima facie evidence that reasonable steps were undertaken to notify relevant custodians of preservation obligations.[44]

The rule should also emphasize that intervention in routine operations is unnecessary unless the failure to do so is intended to deprive another of the use of relevant evidence. This could be accomplished by a cross-reference to an amended Rule 37(e) to clarify that point.

The role of proportionality, embodied in Rule 26(b)(2)(C), should also be acknowledged. In *Rimkus Consulting v. Cammarata,*[45] the court noted that "[w]hether preservation or discovery conduct is acceptable in a case depends on what is *reasonable,* and that in turn depends on whether what was done—or not done—was *proportional* to that case and consistent with clearly established applicable standards." Accordingly, a cross-reference to Rule 26(b)(2)(C) would be appropriate.

C. Bright-Line Guidance

Articulation of a standard of care ("reasonableness") is not enough, although it is essential. The Rule itself, an accompanying Committee Note, or authorization for local rules or Standing Order must also provide presumptive limits on the scope of the duty to preserve along the lines suggested by the Seventh Circuit E-Discovery Project.[46] This would reinforce the need for early discussion and agreement on preservation issues, a key feature of the 2006 Amendments.[47]

Thus, the necessity of preservation of the following categories would not be required absent identification of the need and early agreement among the parties:

(1) Deleted, slack, fragmented or unallocated data on hard drives;

(2) Random access memory (RAM) or other ephemeral data;

(3) On-line access data such as temporary internet files;

(4) Data in metadata fields that are frequently updated; such as last opened dates;

(5) Backup data that is substantially duplicative of more accessible data available elsewhere; and

(6) Other forms of ESI which require extraordinary affirmative measures not utilized in the ordinary course of business.

Providing specific requirements would elevate the effectiveness of the early discussion of preservation in the "meet and confer" process. It would also be useful to amend Rules 16(b) and 26(f) to provide access to a judicial officer following a meet and confer to resolve any remaining preservation issues. Currently, the discovery plan for which counsel are jointly responsible under Rule 26(f) does not require a description of disputed preservation issues and the list of topics for discussion at the Rule 16(b) do not include preservation topics.

Yet another approach, analogous to the quantitative limits on discovery,[48] would be to place presumptive limitations on the total number of "key custodians" and information systems whose relevant information must be preserved.[49]

D. Increased Reliance on Rule 37

Spoliation sanctions in Federal Courts are traditionally imposed through the exercise of inherent court powers.[50] For a variety of reasons, including doubts about the authority to use inherent sanctioning power in the absence of bad faith,[51] it is time to more fully engage rule-based sanctions. As noted above, both Rules 37(b) and (c) could easily be amended to clarify their applicability to failures to preserve.

In addition, experience with Rule 37(e) suggests the need for clarification and, perhaps, a broadened scope. The Rule was intended to provide a uniform culpability standard for routine, good-faith losses of ESI which are not the result of intentional acts. This had been a perennial and well-known problem due to differing Circuit views on the sufficiency of mere negligence to sustain spoliation sanctions.

However, despite Rule 37(e), some have concluded that "it can't be routine and good-faith not to suspend your process once you know there is litigation."[52] Under this view, the presence of a duty to preserve excuses courts from consideration of the level of culpability involved. This misinterpretation of Rule 37(e) could be easily corrected by specifying that there must be "intentional or reckless actions designed to avoid known preservation obligations" to avoid the impact of the Rule.

In addition, Rule 37(e) could be broadened to apply to all forms of routine, good faith losses, a proposal which was originally made by the American College at the time of the 2006 Amendments.[53] This would reinforce the need for and efficacy of records management and other neutral policies and practices which enhance predictability and encourage access to information needed in litigation.

III. Conclusion

Now that the Duke Conference has fully aired the continuing burdens of modern litigation, especially e-discovery, it is time for the Advisory Committee to address the preservation issue (again). There is an understandable reluctance on their part, of course, to act so quickly after the 2006 Amendments. However, it is time to move from ad hoc and conflicting preservation decisions to clear-cut, rule-based standards. Only in this way can we begin the "bending of the curve" away from the disproportionate role preservation issues have assumed in litigation planning and judicial management.

Endnotes

1 Papers submitted in connection with the Duke Conference are available at http://civilconference.uscourts.gov/LotusQuickr/dcc/Main.nsf/h_Toc/B896CCD29A7DE0C88525764100492D17/?OpenDocument (navigate to Empirical and Panel sections) (hereinafter "Duke Papers").

2 Willoughby and Jones, *Sanctions for E-discovery Violations: By the Numbers* 1, Duke Papers.

3 West v. Goodyear Tire & Rubber Co., 167 F.3d 776, 779 (1999).

4 The Panel consisted of two federal judges (a district judge and a magistrate judge), a plaintiff's employment counsel, two defense counsel, and one former general counsel and was moderated by the President Elect of the American College of Trial Lawyers.

5 Civil Justice Reform Group, Lawyers for Civil Justice, U.S. Chamber Inst. for Legal Reform, *Litigation Cost Survey of Major Companies* 3, 7, Duke Papers.

6 *See Elements of a Preservation Rule*, Duke Papers (hereinafter "*Elements*").

7 Seventh Circuit Pilot Program On E-Discovery, Principle 2.04 (Scope of Preservation) (2009), *available at* http://www.ilcd.uscourts.gov/Statement%20-%20Phase%20One.pdf.

8 Lawyers for Civil Justice, *White Paper: The Need for Clear, Concise, and Meaningful Amendments to Key Rules of Civil Procedure,* Duke Papers (hereinafter "*White Paper*").

9 *See infra* Section IIA ("Pre-Litigation Conduct").

10 *See infra* Section IIB ("Crafting the Rule-Based Duty to Preserve").

11 Lawyers for Civil Justice suggests a proposed rule (Rule 26(h)(1) Duty to Preserve) that limits preservation to matters that "would enable a party to prove or disprove a claim or defense" which "must comport with the proportionality assessment required by Rule 26(b)(2)(C). *White Paper*, *supra* note 8, at 36.

12 *Id*. at 36-37 (Rule 26(h) Specific Limitations on Electronically Stored Information).

13 Association of Corporate Counsel, *Civil Litigation Survey of Chief Legal Officers and General Counsel* 3, Duke Papers.

14 *See infra* Section IIIC ("Bright-Line Guidance").

15 Rule 37(b)(2)(A): "[If a party] fails to obey an order to *preserve evidence or* provide or permit discovery."

16 Rule 37(c)(1): "[If a party] fails to *preserve or* provide information as required by these rules or identify a witness as required by rule 26(a) or (e). . ."

17 Lawyers for Civil Justice would simply modify Rule 37(e) to apply to ban sanctions "[a]bsent willful destruction." *White Paper, supra* note 8, at 38.

18 Thoughtful jurists acknowledge that remedies for "failing to preserve" are

best understood as efforts to seek "discovery sanctions." *See, e.g.,* Casale v. Kelly, 2010 WL 1685582, at *10 (S.D.N.Y. April 26, 2010) (Scheindlin, J).

19 Chambers v. NASCO, 501 U.S. 32, 50 (1991).

20 Thomas Y. Allman, *The Need for Federal Standards Regarding Electronic Discovery,* 68 Def. Couns. J. 206, 209 (2001).

21 *See* Fordham E-Discovery Conference Participant Memo 35 (2004) ("Upon [notice of] commencement of an action, all parties must preserve documents and tangible things that may be required to be produced pursuant to Rule [26(a)(1)and] Rule 26(b)(1), [except that materials described by Rule 26(h)(2) need not be preserved unless so ordered by the court or good cause]."), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/E-Discovery_Conf_Agenda_Materials.pdf.

22 *See* Report Of The Civil Rules Advisory Committee 44 (2005), *available at* http://www.uscourts.gov/uscourts/RulesAndPolicies/rules/Reports/CV5-2005.pdf.

23 Kenneth J. Withers, *"Ephemeral Data" and the Duty To Preserve Discoverable Electronically Stored Information*, 37 U. Balt. L. Rev. 349, 377 (Spring 2008) ("By the time the parties sit down at the Rule 26(f) conference, the preservation issues surrounding ephemeral data may be moot and the fate of the responding party may already be sealed, if sanctions are later found to be warranted.").

24 Retention was listed as discussed in only thirty-five percent of the cases where ESI was discussed, which constituted about fifty percent of the cases surveyed. *See FJC Civil Rules Survey* 15-24, Duke Papers.

25 28 U.S.C. § 2072 (a-b) (The Supreme Court shall have the power to prescribe "general rules of practice and procedure" provided they do not modify "substantive" rights).

26 498 U.S. 533 (1991).

27 *Id*. at 553.

28 130 S. Ct. 1431 (2010).

29 *Id.* at 1442-1443.

30 Rule 27 ("Depositions to Perpetuate Testimony") provides for limited discovery "before an action is filed" to "prevent a failure or delay of justice."

31 Beil v. Lakewood Eng'g & Mfg. Co., 15 F.3d 546 (6th Cir. 1994) ("Rule 37 does not, nor does any procedural rule, apply to actions that occurred prior to the lawsuit.").

32 271 F.3d 583, 590 (4th Cir. 2001).

33 632 F. Supp. 2d 494, 505 (D. Md. 2009).

34 501 U.S. 32 (1991). *See id.* at 74 (Kennedy, J., dissenting) ("By exercising inherent power to sanction pre-litigation conduct, the District Court exercised authority where Congress gave it none.").

35 *See* 501 U.S. at 55 n.17 ("Although the fraudulent transfer of assets took place before the suit was filed, it occurred after Chambers was given notice, pursuant to court rule, of the pending suit.").

36 Danis v. USN Commc'ns, 2000 WL 1694325, at *32 n.20 (N.D. Ill. Oct. 23, 2000) (noting that the PSLRA [15 U.S.C. §78u-4(b)(3)(C)(i)] requires a defendant in a securities action to preserve evidence, but "sanctions may be imposed under the PSLRA only for willful document destruction").

37 Chambers v. NASCO*,* 501 U.S. 32, 46 (1991).

38 *See, e.g.,* Letter from Robert L. Byman, American College of Trial Lawyer Lawyers, to Peter G. McCabe, Secretary, Rules Advisory Committee, Proposed Amendments to the Federal Rules of Civil Procedure (Jan. 25, 2005) ("It would enhance . . . the entire body of the Federal Rules" if the Rules were amended "to state a standard of care for production and preservation—which we think should be reasonableness.").

39 *See* Pension Comm. v. Bank of Am. Sec., LLC, 2010 WL 184312 (S.D.N.Y. Jan. 15, 2010) (applying strict liability standard to parties who did not immediately impose written litigation holds).

40 *White Paper*, *supra* note 8, at 35.

41 *See also* Sedona Conference® Legal Hold Commentary, Guideline 6, comment, at 13 ("[T]here are circumstances where a notice may not be necessary[, such as situations when] the information can be immediately secured without requiring preservation actions by employees.").

42 The Committee Note to Rule 37(e) provides that "[w]hen a party is under a duty to preserve information because of pending or reasonably anticipated litigation, intervention in the routine operation of an information system is one aspect of what is often called a 'litigation hold.'"

43 2008 WL 4850116, at *7 (D. Ariz. Nov. 7, 2008).

44 *Elements, supra* note 6, para. 5 ("Litigation Hold").

45 2010 WL 645353, at *6 (S.D. Tex. Feb. 19, 2010).

46 Seventh Circuit Pilot Program On E-Discovery, *supra* note 7, Principle 2.04 (Scope of Preservation) ("[After listing categories of ESI which are 'generally' not discoverable], if any party intends to request the preservation or production of these categories, then that intention should be discussed at the meet and confer or as soon thereafter as practicable.").

47 Thomas Y. Allman, *Managing Preservation Obligations After the 2006 Federal E-Discovery Amendments*, 13 Rich. J. L. & Tech. 9 (2007) (describing the requirement that "preservation issues" be discussed at the Rule 26(f) conference as a "widely supported change" in the 2006 Amendments).

48 Rule 30(a)(2)(A) (no more than ten depositions); Rule 33(a) (no more than twenty-five written interrogatories); *see also* Rule 30(d)(1) (deposition limited to one day of seven hours unless otherwise stipulated or ordered by the court).

49 Lawyers for Civil Justice adopts this approach as one of a number of possible limitations on the permissible scope of discovery requests under Rule 34. *See White Paper*, *supra* note 8, at 32 (amended Rule 34 (b)(1)(B)(iii) ("a reasonable number of custodial or other information sources for production, not to exceed 10")). Although not explicitly directed at preservation obligations, it would have implications for those duties.

50 Unigard Sec. Ins. v. Lakewood Eng'g*,* 982 F.2d 363, 367 (9th Cir. 1992) (rejecting lower court argument that Rule 37(b) extends to situations where orders "would be futile, because the evidence has been destroyed").

51 Rimkus Consulting v. Cammarta, 2010 WL 645353, at *5, *7 (S.D. Tex. Feb. 19, 2010) ("[T]he Supreme Court's decision in *Chambers*[, 501 U.S. 32, 43-46 (1991),] may also require a degree of culpability greater than negligence.").

52 Panel Discussion, *Sanctions in Electronic Discovery Cases: Views from the Judges*, 78 Fordham L. Rev. 1, 30-31 (October 2009)("[W]hat this toothless thing [Rule 37(e)] really tells you is the flip side of a safe harbor. It says if you don't put in a litigation hold when you should there's going to be no excuse if you lose information.").

53 *See* Letter from the American College of Trial Lawyers to Advisory Committee 4 (January 25, 2005) ("If a safe harbor is introduced into the Rules[, which the ACTL then supported in principle], it should extend to all types of information.").

Vermont Attorney General Uses State Consumer Fraud Statute to Implement Consumer Product Penalties

*By Hal Stratton**

The provisions of Section 218 of the Consumer Product Safety Improvement Act of 2008 ("CPSIA")[1] give the attorneys general of each of the fifty states the authority to enforce certain provisions of federal product safety statutes administered by the Consumer Product Safety Commission ("CPSC").[2] To date, this authority has not been used by the state attorneys general. However, a recent enforcement action by the Vermont Attorney General provides insight as to what product safety stakeholders and those in the consumer product supply chain may expect in the future as to enforcement of product safety laws by the states and their attorneys general.

State Attorney General Product Safety Powers Granted by the CPSIA

In enacting the CPSIA, Congress gave state attorneys general broad power to enforce certain federal product safety statutes. These powers include, among others, the right to proceed in U.S. district court to enjoin product safety stakeholders from a number of activities, including selling products that violate a CPSC safety regulation, selling products that have been recalled, selling banned hazardous substances and selling products that do not meet the certification provisions provided in the CPSIA.[3] In addition, state attorneys general now also have the authority to proceed in U.S. district court, on their own and without the CPSC, to enjoin the sale of products that exhibit a "substantial product hazard" under federal law, a power which previously has been reserved to and within the province and discretion of the CPSC.[4]

However, the CPSIA does not give the state attorneys general authority to impose or seek monetary penalties against parties who violate federal product safety laws. Such provisions were included in various drafts of CPSIA legislation as it worked its way through Congress. While this language was the source of much behind-the-scenes debate and negotiation, the final version of the CPSIA did not include authority for state attorneys general to impose penalties under federal statutes which they may otherwise enforce. The lack of authority to recover monetary damages and penalties under the CPSIA will likely have a significant effect upon whether any of the state attorneys general will routinely use powers granted in the CPSIA under the federal statutes alone in consumer product enforcement efforts in the future. With budget cuts virtually across the board in the states, any action that does not allow the state to collect monetary damages or penalties will likely not take priority.

Vermont Attorney General Action

This does not mean, however, that state attorneys general will not become more involved in the enforcement of consumer product safety laws in the future. The enactment of the CPSIA and the publicity surrounding certain high-profile recalls over the past few years beginning in 2007, have served to raise the profile of product safety nationwide, including among the state attorneys general. A recent action by the Vermont Attorney General against Dollar Tree Stores, Inc. ("Dollar Tree") illustrates the inherent power, aside from federal law, the state attorneys general possess under state law to enforce product safety laws and perhaps portends what will likely be the most widely-used procedure by the states to ensure consumer product safety in their jurisdictions.[5]

In March 2006[6] and October 2007,[7] Dollar Tree, in cooperation with the CPSC, recalled children's jewelry that contained lead. In addition, as grounds for the action, the Vermont Attorney General noted reports that Dollar Tree sold bracelets containing cadmium in November 2007. After the announcement of these recalls, the Vermont Attorney General's office purchased four products similar to those that were subject to the recall from Dollar Tree and had them tested. The results of the tests indicated high levels of cadmium in some of the products and high levels of lead in others. Prior to learning of the Vermont Attorney General's actions, Dollar Tree adopted procedures to ensure that it would not sell any further products containing lead or cadmium. The CPSC did not seek (or as yet has not sought) a penalty from Dollar Tree under the federal law in connection with the recalls, and, as discussed above, the Vermont Attorney General did not have authority under the CPSIA to seek such penalties. So, it would seem the case was closed at that point.

However, the Vermont Attorney General's office wasn't finished with legal action against Dollar Tree. It proceeded not under powers granted by the CPSIA, but rather under Vermont state law, specifically the Vermont Consumer Fraud Act.[8] The Vermont Attorney General's office used the following provision of this act to seek relief under Vermont state law against Dollar Tree: "(a) Unfair methods of competition in commerce, and unfair or deceptive acts or practices in commerce, are hereby declared unlawful."[9] The contention of the Vermont Attorney General under this language was that the selling of children's jewelry containing high levels of toxic substances such as cadmium and lead constitutes an unfair or deceptive trade practice under the Vermont statute.

In addition, however, unlike the attorney generals' power under the CPSIA, the Vermont Attorney General, once an unfair or deceptive act such as selling an unsafe product has been determined, has the authority to seek a civil penalty under the provisions of 9 V.S.A. § 2458(a)(1), which provides for penalties of $10,000 per violation. Under this provision,

....

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Dollar Tree agreed to pay the state of Vermont a civil penalty for all violations of $100,000.

State Consumer Protection Laws

Each state has a consumer protection or fraud statute similar to Vermont's which can be enforced by the state attorney general.[10] Although these statutes differ from one another in various ways, each provides their state attorney general with wide latitude to enforce unfair or deceptive trade practices. Each of these statutes also provides for the recovery of monetary damages and penalties for their violation. As product safety laws and issues evolve, state attorneys general and their staffs will likely be turning to their state consumer protection statutes more and more to address the violation of federal consumer product safety laws and the sale of unsafe products alleging that such sales constitute unfair or deceptive trade practices under the state statute.

CPSIA and Federal Preemption

The Consumer Product Safety Act ("CPSA")[11] and the Federal Hazardous Substances Act ("FHSA")[12] provide that any state or local regulation that is not identical to a regulation addressing the same risk promulgated under the CPSA or FHSA by the CPSC is ineffectual and thus preempted. Additionally, prior to the CPSIA, states had no authority to enforce federally-imposed recalls or other federal enforcement actions under federal law. This statutory scheme clearly indicated a preference for preemption of local and state product safety law by federal law.

These preemption provisions as they pertain to regulations are maintained by the CPSIA. However, in granting enforcement powers to the state attorneys general under the CPSIA, Congress has effectively put the state attorneys general virtually on par with the CPSC regarding the injunction of the sale of consumer products exhibiting a substantial product hazard and further allows them to enforce federally promulgated regulations and federally-administrated recalls. The issue of preemption in the field of consumer product safety will undoubtedly be the subject of additional litigation in the future.

Potential Future Enforcement Actions

The involvement of state attorneys general in consumer product safety enforcement is just beginning, although a number of the larger states, such as California and Illinois, have been involved in product safety issues even before the enactment of the CPSIA. Previously, most states have relied on the federal government to enforce consumer product safety law and sought to enforce only state statutes which specifically address product safety. However, the recent actions of the Vermont Attorney General may portend a new era in state product safety enforcement, where specific state product safety laws do not exist. All consumer product stakeholders in the supply chain, including manufacturers, distributors, importers, and retailers are subject to these state actions and authority. In looking toward the future, consumer product stakeholders should expect the following:

1. More and more states, through their attorneys general, will become involved in consumer product safety enforcement, primarily through their state consumer protection statutes, even where specific state consumer product safety statutes do not exist.

2. States will seek monetary damages from stakeholders and those involved in the consumer product supply chain for violations of consumer product safety law through their state consumer protection statutes even where the CPSC does not.

3. Depending on the circumstances of the situation, states may engage in multistate action as to consumer product enforcement, joining together to collectively assert claims stemming from each state's consumer protection statute. The state attorneys general have a long history of multistate action in various consumer areas, including among others, tobacco, pharmaceuticals, consumer finance, and, more recently, the Toyota recalls.

4. The enforcement powers of the CPSC and the states are not mutually exclusive. States may take enforcement action under their respective consumer protection statutes in certain circumstances regardless of any action or inaction by the CPSC.

Consumer stakeholders should monitor and consider the actions and the powers of the state attorneys general and the states as well as the CPSC and the federal government in their product safety planning, assurance, and remediation programs.

Endnotes

1 15 U.S.C. § 2073(b).

2 These statutes include the Consumer Product Safety Act, 15 U.S.C. §§ 2051-2089; the federal Hazardous Substances Act, 15 U.S.C. §§ 1261-1278; the Flammable Fabrics Act, 15 U.S.C. §§ 1191-1204; the Poison Prevention Packaging Act, 15 U.S.C. §§ 1471-1477; the Virginia Graeme Baker Pool and Spa Safety Act, 15 U.S.C. §§ 8001-8008; the Children's Gasoline Burn Prevention Act, Pub. L. No. 110-278, 122 Stat. 2602 (codified at 15 U.S.C.A. § 2056 note); and the Refrigerator Safety Act, 15 U.S.C. §§ 1211-1214.

3 15 U.S.C. § 2073(b)(1).

4 15 U.S.C. § 2073(b)(2)(C).

5 Assurance of Discontinuance, *In re* Dollar Tree Stores, Inc., State of Vermont, Washington County, *available at* http://www.atg.state.vt.us/assets/files/Dollar%20Tree%20AOD%20-%202010-2-5.pdf.

6 Press Release, Consumer Prod. Safety Comm'n, Dollar Tree Stores Inc. Toy Jewelry Recalled for Lead Poisoning Hazard to Children (Mar. 23, 2006), *available at* http://www.cpsc.gov/CPSCPUB/PREREL/prhtml06/06118.html.

7 *Id.*

8 9 V.S.A. §§ 2451-2480n.

9 9 V.S.A. § 2453(a).

10 *See* State Attorneys General Powers and Responsibilities (L. Ross & E. Myers eds., 2d ed. 2008).

11 15 U.S.C. §§ 2051–2089.

12 15 U.S.C. §§1261–1278.

State "Anti-SLAPP" Statutes Codify First Amendment Doctrine Protecting a Corporation's Right to Petition

*By Raymond J. Tittmann**

On January 21, 2010, the Supreme Court found in *Citizens United v. Federal Election Commission*[1] that corporations have First Amendment rights in the context of campaign finance. But in some respects that ruling was not as newsworthy as critics suggest. Ironically, individuals and groups that are often at odds with corporate America[2] are largely responsible for a series of powerful statutes that have spread across the country over the last twenty years[3] applying the First Amendment's right of petition to corporate entities.

As illustrated in the chart at the conclusion of this article, about twenty-eight states now have statutes enabling defendants to attack at the outset of litigation "Strategic Lawsuits Against Public Participation" in government, or "SLAPPs" as they are popularly called. In December 2009, Representative Steve Cohen (D-TN) introduced a federal anti-SLAPP statute (H.R. 4364), which is awaiting consideration.

The anti-SLAPP movement is built on a fifty-year-old line of U.S. Supreme Court authority applying the First Amendment to protect a citizen's—including a corporate citizen's—petitioning activity (known as the "*Noerr-Pennington* doctrine").[4] One can reasonably speculate that Justice Alito had the *Noerr* line of cases in mind when President Barack Obama famously criticized the Court for reversing a hundred years of precedent. *Citizens United* relied on the *Noerr* line of cases in noting that corporations have consistently received First Amendment protection.[5]

In the most sympathetic scenario, anti-SLAPP statutes are motivated by stories of large corporations punishing community activists in court, alleging that an individual or group's petitioning activity interfered with a business opportunity. However, careful to achieve maximum effect, drafters have typically included several elements that are extremely useful to corporate entities of all sorts.

First, anti-SLAPP statutes typically define "person" broadly to include corporate entities. The Illinois Citizen Participation Act, for example, defines person as "any individual, corporation, association, organization, partnership, two or more persons having a joint or common interest, or other legal entity."[6]

Second, the right to petition the government includes the right to petition all branches of government, including the judicial branch. Thus a corporate defendant's pleadings in court are protected, and countersuits criticizing those pleadings qualify as "SLAPP" suits subject to immediate dismissal.

Third, anti-SLAPP statutes often extend protection to acts *in furtherance* of the right to petition. Thus, for example, a corporation's pre-lawsuit negotiations are also protected, and corporations will not be held liable for such conduct.

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There are countless examples of corporate defendants using anti-SLAPP statutes to their benefit, especially in California. Still, in other states like Illinois, the statute appears underutilized, judging from the scarcity of published decisions. This article discusses the basic statutory framework and the powerful tools available to corporate defendants under anti-SLAPP statutes.

I. The Statutory Framework

Though legislatures passing anti-SLAPP statutes are often motivated by stories of sympathetic defendants, the legislation typically requires only two considerations, and neither turns on the relative strength of the parties or the political nature of the petition: (1) whether the conduct complained of is protected by the right to petition, and (2) whether the petitioning activity was "genuine," i.e., motivated to achieve a favorable *outcome* rather than taking advantage of the *process* (e.g., as a delaying tactic).

For example, the Illinois anti-SLAPP statute, which is similar to most anti-SLAPP statutes, permits early motions to dismiss complaints against conduct that is "immune" under the First Amendment right to petition. "Immune" under this statute means the conduct was (1) "in furtherance of the constitutional rights to petition, speech, association, [or] participation . . . regardless of intent or purpose . . ."; (2) "except when not genuinely aimed at procuring favorable government action, result or outcome."[7]

These two elements of immunity therefore create a two-step process, which is common among anti-SLAPP statutes.

On the first step, there is no doubt that the right to petition protects a corporate lawsuit seeking redress from the courts, to the same extent it protects an activist petitioning the government. In fact, this has long been the holding of the Supreme Court under the *Noerr-Pennington* doctrine.[8]

For example, in *Shekhter v. Financial Indem.*, Allstate sought redress in the courts for its belief that a policyholder engaged in insurance fraud. The policyholder countersued, claiming that the suit itself constituted a tortious breach of contract (i.e., bad faith). Allstate successfully argued that the policyholder's SLAPP countersuit should be dismissed, as the statute applied to Allstate's pleading with the same merit it would apply to an environmental activist sued for petitioning the EPA.[9]

The "not genuine" language in the second step of the inquiry comes from the *Noerr* line of Supreme Court decisions holding that a "sham" petition is not protected:

> The "sham" exception to *Noerr* encompasses situations in which persons use the governmental *process*—as opposed to the *outcome* of that process—as an anticompetitive weapon. A classic example is the filing of frivolous objections to the license application of a competitor, with no expectation of achieving denial of the license but

simply in order to impose expense and delay. A "sham" situation involves a defendant whose activities are "**not genuinely aimed at procuring favorable government action**" at all, not one "who 'genuinely seeks to achieve his governmental result, but does so *through improper means*.'"[10]

The Supreme Court has interpreted "genuine" in this context to have both an objective and subjective component. Thus, to establish the "sham" exception, the infringing party would have to show that the protected conduct was (1) "objectively baseless"; and (2) subjectively aimed at gaining an advantage from the process alone, and not from the outcome.[11]

Thus, the only two issues in a typical anti-SLAPP motion are (using the language of the Illinois statute) whether the infringing plaintiff can show that:

(1) The counterclaim does *not* complain of acts in furtherance of the constitutional rights to petition; and

(2) The protected conduct is *not* genuinely aimed at procuring favorable government action, both (a) subjectively and (b) objectively (i.e., the infringed party's claims are "objectively baseless").

Obviously none of these requirements suggest that corporations of whatever size and interest are not entitled to the same protection of an individual or activist.

II. The Power Is in the Procedure

Substantively, anti-SLAPP statutes do no more than what the First Amendment already does—protect the right to petition. But the statutes provide defendants with tremendous and rare procedural power to safeguard those rights.

There are basically four key procedural elements. Anti-SLAPP statutes entitle the defendant of a SLAPP suit to file (1) an early motion to dismiss that (2) requires the infringing claimant to present clear and convincing evidence that the claim does not infringe—either because the claim does not implicate protected conduct or because the protected conduct was a sham. (3) Discovery is generally stayed pending a decision, thus preserving costs. And (4) the moving party is entitled to attorneys fees if it prevails.

The "clear and convincing" standard is adopted from federal First Amendment law, which always places a "clear and convincing" evidentiary burden on the party imposing on First Amendment rights.[12]

The evidentiary requirement means the infringing plaintiff cannot rest on the facts as pled: "In this respect, a special motion to strike is akin to a motion for summary judgment. A plaintiff cannot rely solely on the allegations set forth in his pleadings, nor may the court simply accept those allegations."[13]

Anti-SLAPP procedures therefore provide the evidentiary advantage of a defense motion for summary judgment, forcing the plaintiff to meet a heavy burden, but the plaintiff must meet this burden at the initial stages of litigation before discovery (in Illinois, the anti-SLAPP motion must be decided within 90 days after the motion is filed):

> [I]t "would subvert the intent of the anti-SLAPP legislation" to allow a plaintiff to conduct discovery—thereby delaying adjudication of the defendant's special motion to strike and increasing the financial burden on the defendant—on anything less than a showing of good cause.[14]

State anti-SLAPP statutes generally apply in federal court as well, because these anti-SLAPP procedures do not conflict with the Federal Rules. Accordingly, state anti-SLAPP statutes "add[] an *additional*, unique weapon whose sting is enhanced by an entitlement to fees and costs":

> Two aspects of California's Anti-SLAPP statute are at issue: the special motion to strike, Cal. Civ. P.Code § 425.16(b), and the availability of fees and costs, Cal. Civ. P.Code § 425.16(c). We conclude that these provisions and Rules 8, 12, and 56 "can exist side by side . . . each controlling its own intended sphere of coverage without conflict." *Walker v. Armco Steel*, 446 U.S. at 752, 100 S.Ct. 1978, 64 L.Ed.2d 659.[15]

"Plainly, if the anti-SLAPP provisions are held not to apply in federal court, a litigant interested in bringing meritless SLAPP claims would have a significant incentive to shop for a federal forum."[16]

State provisions for mandatory attorneys fees also apply in federal court.[17]

One significant aspect of the state anti-SLAPP statutes may not apply in federal court. The Ninth Circuit generally applies the discovery standard of Fed. R. Civ. Proc. 56(f) to anti-SLAPP motions in federal court, meaning that the discovery stay does not apply if the infringing party can show that discovery is needed to respond.[18] But federal courts still recognize the need to decide anti-SLAPP motions early if possible, such as when resolution can be based on the pleadings or evidence already before the court.[19]

If discovery is allowed and the moving party prevails on the anti-SLAPP motion afterwards, it may be entitled to attorneys fees for the discovery. As the Southern District of Indiana has explained:

> [F]ee awards to prevailing defendants under the anti-SLAPP statute should reimburse them for all time reasonably spent on the litigation to achieve the successful result. That time will often include, as it does here, taking, responding to, and defending necessary discovery. Those activities will be necessary preludes to a successful motion. They should be reimbursed to make the defendant whole and to make the plaintiff bear the financial burden of the defense.[20]

III. Anti-SLAPP Statutes Apply to a Variety of Claims

Once a court determines that genuine protected conduct is implicated, there is no other limitation. For example, policyholders have failed in attempts to argue that bad faith suits are exempt from anti-SLAPP limitations: "To the extent that [the plaintiff] suggests bad faith claims should be exempt from anti-SLAPP motions case law holds otherwise. There is simply no authority for creating a categorical exception for

any particular type of claim, as the California Supreme Court recently affirmed . . . ."[21]

Not only does this law protect a corporation's contentions in court, it also protects acts "in furtherance" of the right to petition. The California Supreme Court interprets "in furtherance" to protect conduct in anticipation of litigation:

> [The complained-of conduct], apparently, was in anticipation of litigation, and courts considering the question have concluded that "[j]ust as communications preparatory to or in anticipation of the bringing of an action or other official proceeding are within the protection of the litigation privilege of Civil Code section 47, subdivision (b), . . . such statements are equally entitled to the benefits of [the anti-SLAPP statute]."[22]

Thus, pre-litigation attorney and party discussions and settlement offers are most likely protected.[23]

An anti-SLAPP motion can also challenge "mixed" causes of action that only partially challenge litigation conduct:

> A mixed cause of action is subject to [the anti-SLAPP statute] if at least one of the underlying acts is protected conduct, unless the allegations of protected conduct are merely incidental to the unprotected activity. A plaintiff cannot frustrate the purposes of the anti-SLAPP statute through a pleading tactic of combining allegations of protected and non-protected activity under the label of one "cause of action."[24]

A corporate defendant would, therefore, only need to show that some aspect of a cause of action attacks the defendant's litigation or pre-litigation conduct.

IV. Conclusion

Courtesy of various First Amendment activists who traditionally find themselves at odds with corporate America, in part, numerous state anti-SLAPP statutes have followed Supreme Court doctrine in giving corporations tremendous abilities to block complaints attacking a corporation's litigation or pre-litigation conduct. Below is a chart of approximately twenty-eight states with anti-SLAPP laws of varying force. Even if a corporation's own state does not have an anti-SLAPP law, the corporation can make similar arguments under the *Noerr-Pennington* doctrine—though without the procedural advantages. It has thus long been the holding of the Supreme Court that the First Amendment's right of petition applies to corporations.

V. States and Territories with Anti-SLAPP Statutes and Judicial Doctrines[25]

State	Citation and Comment
States with Anti-SLAPP Statutes	
Arizona	• ARS § 12-751, signed 4/28/2006 • Limits "the right of petition" to specifically exclude judicial proceedings
Arkansas	• AC § 16-63-501, signed 4/11/2005 • Precludes liability for any "privileged communication" as defined in the Act • Immunity would not apply to a "statement or report made with knowledge that it was false or with reckless disregard of whether it was false."
California	• CCP § 425.16 • Gives SLAPP targets an opportunity to have the court rule at the outset whether a SLAPP filer can show a probability of winning the suit. If the judge finds that the filer cannot prove that the case has a probability of winning, the court will "strike" the complaint and dismiss the suit. The court will also order the filer to pay to the SLAPP target his or her attorneys' fees and costs.
Delaware	• Delaware Code § 8136

Florida	• FS § 718.1224 and § 720.304(4) give full anti-SLAPP protection to condominium and land parcel owners petitioning the government in that capacity. • FS § 768.295 is a very weak anti-SLAPP statute limited to suits by a government agency.
Georgia	• CG § 9-11, enacted in 1996 • In *Berryhill v. Georgia Community Support*,[26] the Georgia Supreme Court held that the state's anti-SLAPP statute covers only speech linked to official proceedings.
Guam	• GCA Title 7, § 17101, enacted in 1998
Hawaii	• HRS Chapter 634F, signed 6/25/2002
Illinois	• 735 ILCS 110, the Citizen Participation Act • Requires courts to decide anti-SLAPP motions within 90 days; discovery is suspended pending a decision • Acts in furtherance of the constitutional rights to petition are immune from liability, regardless of intent or purpose, except when not genuinely aimed at procuring favorable government action. • Attorney's fees and costs to be awarded to the prevailing moving party
Indiana	• Indiana Code 34-7-7, effective 6/30/1998
Louisiana	• Code of Civil Procedure Art. 971, effective 8/15/1999 • *Thomas v. City of Monroe Louisiana*[27]: A television station, operating as a corporation, is a "person" authorized to use the special motion to strike. A city employee did not meet the burden to prove that the television station knew a police report was false.
Maine	• 14 MRS § 556, enacted in 1995 • Provides for a special motion to dismiss claims that arise from exercise of the right of petition under the United States and Maine constitutions
Maryland	• ACM § 5-807 (HB 930), signed 5/11/2004
Massachusetts	• Chapter 231, § 59H • Passed both chambers in Jan. 1994 but was vetoed by Governor Weld. The bill was reintroduced as House Bill 1520 and enacted in Dec. 1994 after a second veto by the governor.
Minnesota	• MSA Chap. 554
Missouri	• RSMo § 537.528, effective 8/ 28/2004 • As in many states, SB 807 was a response to a lawsuit.[28]
Nebraska	• NRS § 25-21,241 • Nebraska's anti-SLAPP statute, enacted in 1994, was one of the earliest in the United States. • *Sand Livestock Systems, Inc. v. Svoboda*[29]: A jury awarded $900,000 in damages plus legal fees to the defendant farmers on an anti-SLAPP counterclaim. The plaintiff had sued the farmers for complaining to state regulators. The appellate court overturned and remanded, saying a judge, not a jury, needed to determine whether the lawsuit had any basis.

Nevada	• NRS § 41.635 • Nevada's anti-SLAPP statute was enacted in 1993 and amended 1997.
New Mexico	• NMS § 38-2-9.1, enacted in April 2001
New York	• Civil Rights Law 70-a and 76-a, enacted 1992 • NYCPLR 3211(g) and 3212(h): These two N.Y. Civil Practice rules establish standards for motions to dismiss and for summary judgment in SLAPP cases.
Oklahoma	• OSA §1443.1 • Not specifically an anti-SLAPP statute, but the statute exempts from prosecution for libel any communication made in a "proceeding authorized by law"
Oregon	• ORS § 31.150, amended 2009
Penn.	• 27 PS §§ 7707, 8301 – 8305 • Limited to participation in environmental law or regulation
Rhode Island	• General Laws 9-33 § 1-4, amended in 1995 over the veto of the governor • Protects "any written or oral statement made before or submitted to a legislative, executive, or judicial body, or any other governmental proceeding; any written or oral statement made in connection with an issue under consideration or review by a legislative, executive, or judicial body, or any other governmental proceeding; or any written or oral statement made in connection with an issue of public concern"
Tennessee	• TCA § 4-21-1001, signed into law 6/6/1997
Utah	• UCA §§ 78-58-101-105, effective 4/30/2001
Vermont	• VS § 1041, signed into law 5/6/2006 • Interest was prompted by a case in Barnard where a wealthy landowner sued neighbors and the Zoning Board based on a petition filed to the town Zoning Board. The defendants paid $9500 to settle the case.
Washington	• RCW 4.24.500 - 520 • Enacted in 1989, it was the first modern anti-SLAPP law in the U.S. It passed unanimously in reaction to the plight of a young woman sued for defamation by a real estate company after she helped the state collect back taxes.[30] • The statute was amended in March 2002, with the following explanation (HB 2699, §1): "Although Washington State adopted the first modern anti-SLAPP law in 1989, that law has, in practice, failed to set forth clear rules for early dismissal review. Since that time, the United States Supreme Court has made it clear that, as long as the petitioning is aimed at procuring favorable government action, result, product, or outcome, it is protected and the case should be dismissed. This bill amends Washington law to bring it in line with these court decisions . . . ."

States with Case Law on SLAPPs (But No Statute)	
Colorado	• *Protect Our Mountain Environment, Inc. v. District Court Colorado Supreme Court*[31]: An action against a defendant arising out of defendant's legitimate petition for redress of grievances under the First Amendment is subject to summary judgment. The court promulgated the following elements: (1) whether the plaintiff's action is devoid of reasonable factual support or, if so supported, is lacking a cognizable basis in law; (2) whether defendant's petition for redress of grievances was primarily for the purpose of harassment or some other improper purpose.
West Virginia	• *Webb v. Fury*[32]: "The people's right to petition the government for a redress of grievances is a clear constitutional right and the exercise of that right does not give rise to a cause of action for damages." "[W]e shudder to think of the chill our ruling would have on the exercise of the freedom of speech and the right to petition were we to allow this lawsuit to proceed. . . . We see this dispute between the parties as a vigorous exchange of ideas which is more properly within the political arena than in the courthouse."

Endnotes

1 130 S. Ct. 876 (2010).

2 For example, the Illinois Citizen Participation Act was passed two years ago at the urging of the ACLU. *See* Memorandum in Support of Senate Bill 1434 ("The Citizen Participation Act"), from Mary Dixon, Legislative Dir. Of the Am. Civil Liberties Union of Ill. To Rod Blagojevich, Ill. Governor (June 18, 2007), *available at* www.aclu-il.org/legislative/alerts/sb1434memo.pdf. The Federal anti-SLAPP law under consideration is supported by "consumer rights advocates, environment defense groups, legal reformers and at-home bloggers," according to The Public Participation Project (formerly the Federal Anti-SLAPP Project). *See* www.anti-slapp.org.

3 California, one of the leading states on anti-SLAPP law, enacted Code of Civil Procedure § 425.16 in 1992.

4 *See generally* Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49 (1993).

5 *Citizens United*, 130 S. Ct. at 907 ("[T]he First Amendment protects the right of corporations to petition legislative and administrative bodies.") (citing First Nat. Bank of Boston v. Bellotti, 435 U.S. 765, 792 n.31 (1978); Cal. Motor Transp. Co. v. Trucking Unlimited, 404 U.S. 508, 510-511 (1972); E. R.R. Presidents Conference v. Noerr Motor Freight, Inc., 365 U.S. 127, 137-138 (1961)).

6 735 ILCS 110/10.

7 735 ILCS 110/15.

8 *See* Cal. Motor Transp. v. Trucking Unlimited, 404 U.S. 508, 510 (1972) ("Certainly the right to petition extends to all departments of the Government. The right of access to the courts is indeed but one aspect of the right to petition.").

9 89 Cal. App. 4th 141, 151 (2001) (granting Allstate's anti-SLAPP motion, as its claim for insurance fraud was protected by the First Amendment).

10 City of Columbia v. Omni Outdoor Adver., Inc., 499 U.S. 365, 380 (1991) (citations omitted) (italics in original, bolding added).

11 Prof'l Real Estate Investors, Inc. v. Columbia Pictures Indus., Inc., 508 U.S. 49, 60 (1993).

12 MCI Comms. Corp. v. Am. Tel. & Tel. Co., 708 F.2d 1081, 1155 (7th Cir. 1983); Westmac, Inc. v. Smith, 797 F.2d 313, 318 (6th Cir. 1986).

13 Price v. Stossel, 590 F. Supp. 2d 1262, 1266 (C.D. Cal. 2008).

14 *Id.* at 1267 (citing Sipple v. Found. for Nat'l Progress, 71 Cal. App. 4th 226, 247 (1999)).

15 United States *ex rel.* Newsham v. Lockheed Missile & Space Co., Inc., 190 F.3d 963, 972 (9th Cir. 1999) (emphasis added); *see also* Henry v. Lake Charles Am. Press LLC, 566 F.3d 164, 182 (5th Cir. 2009) (reversing the district court and dismissing the claim under the Louisiana anti-SLAPP statute); Containment Tech Group, Inc. v. Am. Soc'y of Health Sys. Pharms., Case No. 07-0997, 2009 WL 838549, *8 (S.D. Ind. Mar. 26, 2009) (applying Indiana's anti-SLAPP procedures in federal court).

16 *Lockheed*, 190 F.3d at 973.

17 *See, e.g.*, Kearney v. Foley & Lardner, 553 F. Supp. 2d 1178, 1182 (S.D. Cal. 2008) ("[A]ttorneys' fees are mandatory, and therefore, a substantive right under the anti-SLAPP statute."); *Containment Tech.*, 2009 WL 838549, *8 (same).

18 Metabolife Int'l, Inc. v. Wornick, 264 F.3d 832, 845-46 (9th Cir.2001) (allowing discovery upon a proper showing by the responding party).

19 Flores v. Emerich & Fike, Case No. 1:05-CV-0291, 2006 WL 2536615 (E.D. Cal. Aug. 31, 2006); New.Net v. Lavasoft, 356 F. Supp. 2d 1090, 1101-02 (S.D. Cal. 2004); USANA Health Scis., Inc. v. Minkow, No. 2:07-159 TC, 2008 WL 619287, *2 (D. Utah Mar. 4, 2008) ("[T]he anti-SLAPP law does not conflict with the Federal Rules of Civil Procedure because 'both statutes confer discretion on the trial court to permit discovery in the face of a dispositive motion, in the appropriate case and *upon a proper showing*.'") (emphasis in original).

20 Containment Techs. Group, Inc. v. Am. Soc'y of Health Sys. Pharms., Case No. 1:07- 0997DFHTAB, 2009 WL 2750093, *4 (S.D. Ind. Aug. 26, 2009).

21 Beach v. Harco Nat'l Ins. Co., 110 Cal. App. 4th 82, 91 (2003) (citing Equilon Enters. v. Consumer Cause, Inc., 29 Cal. 4th 53, 60 (2002)).

22 Briggs v. Eden Council for Hope & Opportunity, 19 Cal. 4th 1106, 1115 (1999) (citation omitted).

23 *See* GeneThera, Inc. v. Troy & Gould Prof. Corp., 171 Cal. App. 4th 901 (2009) (holding that a settlement offer and attorney communications with opposing counsel were subject to SLAPP motion); Feldman v. 1100 Park Lane Assocs., 160 Cal. App. 4th 1467 (2008) (holding that a landlord's threats to subtenants during a pending dispute were in anticipation of litigation and therefore protected).

24 Salma v. Capon, 161 Cal. App. 4th 1275, 1287-88 (2008) (citations omitted).

25 Information based on www.casp.net, the California Anti-SLAPP project.

26 281 Ga. 439 (2006).

27 833 So.2d 1282 (2002).

28 *See* Mandel v. O'Connor, 99 S.W.3d 33 (Mo. 2003).

29 56 N.W.2d 299 (Neb. Ct. App. 2008).

30 Robert John Real Estate Co. v. Hill, No. 872016983, Superior Court, Clark County, Washington, filed July 14, 1987.

31 677 P.2d 1361 (Colo. 1984).

32 282 S.E.2d 28 (W. Va. 1981).

Shady Grove v. Allstate: A Case Study in Formalism Versus Pragmatism

By Aaron D. Van Oort and Eileen M. Hunter***

Our favorite Supreme Court opinions are 5-4 splits with unusual lineups and Justices apparently voting counter to type. The close vote signals that the case involves a genuinely difficult legal issue. An unusual lineup eliminates ideology as a likely explanation for the outcome. And votes against type indicate that forces contrary to policy preferences are at work. Often, these cases reveal something interesting about the Justices' approaches to interpreting law.

Measured by these criteria, the recent decision in *Shady Grove Orthopedic Associates v. Allstate Insurance Company*, is a treasure trove.[1] The vote is close: 5-4 in some parts, 4-1-4 in others, and 3-1-4 in others still. The lineup is certainly unusual: Justice Scalia, joined in varying parts by Chief Justice Roberts and Justices Stevens, Thomas, and Sotomayor, is squared off against Justice Ginsburg, joined by Justices Kennedy, Breyer, and Alito. Moreover, as the press has trumpeted, the two primary authors could hardly be voting more strongly against type. Justice Scalia—"the scourge of liberals and plaintiff lawyers everywhere"—votes to require federal courts to allow a class action to proceed for statutory penalties under a New York state-law claim, even though New York law expressly precludes that result.[2] On the other side, Justice Ginsburg—the erstwhile champion of "the rights of groups of people who individually would be without effective strength to bring their opponents into court at all"[3]—votes to stop "Shady Grove's attempt to transform a $500 case into a $5,000,000 award."[4] "File this one under man bites dog," a commentator wrote the day the decision was released.[5]

Actually, file this one under the category of "interpretive theory matters." Of the various prisms for viewing the result in *Shady Grove*—federalism versus national preeminence, "conservative" versus "liberal"—the only one that fits is formalism versus pragmatism. The formalist majority saw a New York state law plainly stating that certain claims "may not be maintained as a class action" and concluded that it could not be reconciled with Rule 23's statement that "[a] class action may be maintained."[6] The pragmatic dissent saw a New York law plainly intended to preclude the recovery of statutory penalties in a class action—something that a majority of the Court (and perhaps every member) believes New York has the power to do—and found it easy to reconcile with Rule 23's control over class action procedure. Justice Stevens, joining the majority to produce a judgment but staking out a middle interpretive ground, expressed sympathy for the dissent's approach but ultimately could not get past the New York statute's plain language.

In this article, we summarize the factual and legal background of the *Shady Grove* decision, address the predictable theories of federalism and political preferences for explaining the result and decide they do not fit, and conclude that the difference between formalist and pragmatic approaches to interpreting state law explains the result. We assess the likely consequences of the majority's and dissent's positions in light of the standard arguments for and against formalism. Finally, we offer some predictions regarding *Shady Grove*'s impact on states' approaches to fashioning laws that intersect with Federal Rule of Civil Procedure 23. Because we view the decision as turning more on the phrasing of New York's law than on a substantive disagreement about principles of federalism or federal preemption, we think its implications will be modest and short-lived, lasting only until states amend their laws to take the proper form.

I. The Factual and Legal Background of *Shady Grove*

In 2006, Shady Grove Orthopedic Associates sought payment from Allstate Insurance Company for services provided to a patient. Allstate paid the claims, but paid late, triggering a claim for statutory interest under New York law. When Allstate refused to pay the interest, Shady Grove sued in federal court on behalf of itself and a class of all others to whom Allstate made late payments.[7] Shady Grove asserted federal jurisdiction under the Class Action Fairness Act ("CAFA"), which Allstate did not dispute.[8] Instead, Allstate moved to dismiss, arguing that the New York law under which Shady Grove sued prohibited it from maintaining the case as a class action. The law at issue, New York Civil Practice Law & Rules § 901(b) ("Section 901(b)"), stated:

> Unless a statute creating or imposing a penalty, or a minimum measure of recovery specifically authorizes the recovery thereof in a class action, an action to recover a penalty, or minimum measure of recovery created or imposed by statute may not be maintained as a class action.

According to Allstate, since the statutory interest sought by Shady Grove was a "penalty," Section 901(b) precluded the suit from proceeding as a class action—whether in state or federal court.[9]

The Eastern District of New York agreed with Allstate and held that Section 901(b) barred a class.[10] The Second Circuit affirmed, holding that section 901(b) was "a substantive law that must be applied in the federal forum, just as it is in state court."[11]

The Supreme Court granted certiorari and reversed, holding that Rule 23 was controlling. Although its 5-4, 4-1-4, and 3-1-4 decisions reflect impassioned disagreement among the Justices, they do not reflect disagreement about the

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key components of federal doctrine addressing when federal procedural rules preempt state law. All nine Justices agreed that two cases, *Erie v. Tomkins*[12] and *Hanna v. Plumer*,[13] and the two federal statutes underlying those cases, the Rules of Decision Act[14] and the Rules Enabling Act,[15] provided the applicable legal framework for resolving the case.[16] The Rules of Decision Act "prohibits federal courts from generating substantive law in diversity actions"[17] and is implemented by the *Erie* analysis, which requires federal courts sitting in diversity to apply state substantive law and federal procedural law.[18] The Rules Enabling Act, on the other hand, authorizes the Supreme Court to "'prescribe general rules of practice and procedure' for the federal courts, but with a crucial restriction: 'Such rules shall not abridge, enlarge or modify any substantive right.'"[19] *Hanna*—decided twenty-seven years after *Erie*—clarified that the *Erie* analysis does not apply when a Federal Rule of Civil Procedure "cover[s] the point in dispute."[20] "[W]hen a situation is covered by a federal rule, the Rules of Decision Act inquiry by its own terms does not apply. Instead, the Rules Enabling Act . . . controls."[21]

The Court's first task in *Shady Grove* was thus to decide whether the question before it fell in the *Erie*/Rules-of-Decision-Act category or the *Hanna*/Rules-Enabling-Act category by "determin[ing] whether Rule 23 answers the question in dispute."[22] If it did, the Court would have to determine under *Hanna* whether Rule 23 "exceeds statutory authorization or Congress's rulemaking power."[23] If Rule 23 did *not* answer the question in dispute, however, the Court would have to turn to the "murky waters" of *Erie* to determine whether Section 901(b) is substantive or procedural.[24]

Justice Scalia concluded that *Hanna* applied because Rule 23 directly answered the question in dispute. In his view, Rule 23 "creates a categorical rule entitling a plaintiff whose suit meets the specified criteria to pursue his claim as a class action."[25] Calling Rule 23 a "one-size-fits-all formula for deciding the class-action question," he found a direct conflict between it and Section 901(b) because Section 901(b) "attempts to answer the same question" as Rule 23.[26] Whereas Rule 23 states that "[a] class action may be maintained," Section 901(b) states that a plaintiff's suit "may not be maintained as a class action."[27] Because of this direct conflict, *Hanna* controlled the analysis, and Rule 23 trumped state law. Justice Scalia expressly wrote, however, that the majority was not addressing "whether a state law that limits the remedies available in an existing class action"—as opposed to a state law that limits whether a class action can exist—"would conflict with Rule 23."[28] In the majority's view, Section 901(b) "says nothing about the remedies a court may award; it prevents the class actions it covers from coming into existence at all."[29]

Writing on behalf of the dissenters, Justice Ginsburg disagreed that Section 901(b) conflicted with Rule 23 and argued that it was intended to accomplish the substantive result of prohibiting the award of certain damages in a class action. Whereas the majority had compared the text of Rule 23 to the text of Section 901(b), she argued that the Court's role was to compare the *purpose* of Rule 23 against the *purpose* of Section 901(b).[30] Rather than focusing on the conflict between "may" and "may not," Justice Ginsburg asked why Rule 23 authorizes class actions and why the State of New York enacted Section 901(b)—then compared the answers.[31] As she saw it, Rule 23 was created to afford "a fair and efficient way to aggregate claims for adjudication," whereas Section 901(b) "responds to an entirely different concern." "The fair and efficient conduct of class litigation is the legitimate concern of Rule 23; the *remedy* for an infraction of state law, however, is the legitimate concern of the State's lawmakers and not of the federal rulemakers."[32] Hence *Hanna* did not apply because the "legitimate concern" of Rule 23 and the "legitimate concern" of Section 901(b) did not conflict. Without a federal rule on point, *Erie* controlled. And, under *Erie*, Section 901(b) controlled because its intent was plainly substantive.

Justice Stevens filed a solo concurrence[33] suggesting a third approach to the case. He agreed with the plurality that Rule 23 "squarely governed" the determination whether Shady Grove's case could proceed as a class action, so the *Hanna* analysis controlled.[34] Thus, the district court's job was to ask "whether application of the federal rule 'represents a valid exercise' of the 'rulemaking authority . . . bestowed on this Court by the Rules Enabling Act.'"[35] Examining the text of the Act, which authorizes the Court to prescribe procedural rules provided they do not "abridge, enlarge or modify *any* substantive right,"[36] Justice Stevens concluded that the question of preemption "turns, in part, on the nature of the state law that is being displaced by a federal rule."[37] He articulated his proposed governing rule this way: "A federal rule . . . cannot govern a particular case in which the rule would displace a state law that is procedural in the ordinary use of the term but is so intertwined with a state right or remedy that it functions to define the scope of the state-created right."[38] Justice Stevens ultimately agreed with the plurality that Section 901(b)'s plain language made it procedural, but along the way he reviewed Section 901(b)'s legislative history to determine whether the apparently procedural rule was "so intertwined with a state right or remedy" that it functioned to define the scope of the right it created. Because the legislative history of Section 901(b) created "two plausible competing narratives," Justice Stevens concluded that it could not overcome the effect of the plain text.[39]

II. Federalism and Policy Preferences Do Not Explain *Shady Grove*

So what caused the Justices to split so closely and unusually in *Shady Grove*? The dissent attempted to frame the dispute as a fight about federalism, arguing that the majority gave too little deference to states' rights. Justice Ginsburg argued that, previously, the Court had "avoided immoderate interpretations of the Federal Rules that would trench on state prerogatives without serving any countervailing federal interest,"[40] and had cautioned lower courts to interpret the federal rules "with sensitivity to important state interests."[41] If the majority had only given the history of Section 901(b) "respectful consideration,"[42] and read the federal rules "with due restraint,"[43] the Court could have avoided the "erod[ing] of *Erie*'s federalism grounds."[44]

We do not find the dissent's framing persuasive. For one thing, Justices who have historically favored federalism appear on both sides of the vote. Justice Ginsburg's deference to state's rights is well-established[45]—most prominently appearing in her

dissent in *Bush v. Gore*[46]—so it is no surprise to find her arguing that the Court should have deferred to New York's interest in enacting Section 901(b). But Chief Justice Roberts and Justices Scalia and Thomas have all written or joined majority decisions endorsing federalism principles just as strongly as Justice Ginsburg.[47] Their presence on the opposite side of the decision makes it difficult to attribute the vote in *Shady Grove* to a disagreement about federalism. Another problem with Justice Ginsburg's characterization is that there was no real disagreement among the majority, plurality, concurrence, or dissent over the interpretation of Rule 23. No one argued that Rule 23 did not control the question whether a class action can be certified. The real dispute was over whether the text or purpose of Section 901(b) should govern its interpretation. Something other than federalism drove *Shady Grove*'s outcome.

The result in *Shady Grove* also cannot be explained by the typical political divisions seen on the Court. The five Justices appointed by Republican Presidents and typically thought of as more conservative (Roberts, Scalia, Kennedy, Thomas, and Alito) split three to two, with Roberts, Scalia, and Thomas voting for the "liberal" position of allowing the class action to proceed, and Kennedy and Alito voting for the "conservative" position of barring it from going forward. The three Justices appointed by Democratic Presidents and typically thought of as more liberal (Ginsburg, Breyer, and Sotomayor) split two to one, with Sotomayor voting for the "conservative" position and Ginsburg and Breyer voting for the "liberal" one. Justice Stevens, the lone Justice appointed by a Republican President who is typically thought of as "liberal," ultimately voted for the "liberal" position of allowing the class action to proceed. [48] Of the other 5-4 decisions issued during the October 2009 Term as of the time this article went to press, none had this lineup. Trying to explain *Shady Grove* along political lines simply does not work.

III. *Shady Grove's* Outcome Turns on the Difference between Formalism and Pragmatism

We think the lineup in *Shady Grove* is best explained by the continuum that runs between purely formalistic and purely pragmatic approaches to interpreting state laws in diversity cases. The Justices in the majority took a formalist approach to interpreting Section 901(b), while the dissenters took a pragmatic approach.

"Formalism" has been defined many ways, but we are using the term in the way Cass Sunstein defined it when he identified three commitments that form the basis of formalist interpretive strategies: (1) "promoting compliance with all applicable legal formalities (whether or not they make sense in the individual case)"; (2) "ensuring rule-bound law (even if application of the rule . . . makes little sense in the individual case)" and (3) "constraining the discretion of judges in deciding cases."[49] As Sunstein wrote:

> [F]ormalism is an attempt to make the law both autonomous, in the particular sense that it does not depend on moral or political values of particular judges, and also deductive, in the sense that judges decide cases mechanically on the basis of preexisting law and do not exercise discretion in individual cases. Formalism therefore entails an interpretive method that relies on the text of the relevant law and that excludes or minimizes extratextual sources of law. It tends as well to favor judicial holdings that take the form of wide rules rather than narrow settlements of particular disputes.[50]

The opposite of formalism is antiformalism, or what is more widely called pragmatism. Sunstein defines antiformalism as an approach that "insist[s] that interpretation requires or permits resort to sources other than the text."[51] Judge Richard A. Posner—one of the foremost defenders of legal pragmatism—has written that the "ultimate criterion of pragmatic adjudication is reasonableness"[52] and that pragmatism is "a grab bag that includes anecdote, introspection, imagination, common sense, empathy, imputation of motives, speaker's authority, metaphor, analogy, precedent, custom, memory, experience, intuition, and induction."[53]

No one is a pure formalist, blind to all consequences. Nor is anyone a pure pragmatist, unconstrained in any way by text. Judges fall on a continuum, where "[o]ne pole is represented by those who aspire to textually driven, rule-bound, rule-announcing judgments" and the other "is represented by those who are quite willing to reject the text when it would produce an unreasonable outcome, or when it is inconsistent with the legislative history, or when it conflicts with policy judgments of certain kinds or substantive canons of construction." [54]

The majority and plurality opinions in *Shady Grove* are a case study in formalist interpretive logic, which is no surprise given that Justice Scalia is the foremost formalist on the Court. His book *A Matter of Interpretation* endorses an explicitly formalist approach to interpretation,[55] and his opinion in *Shady Grove* implements that approach. His analysis begins—and largely ends—with the text of the two provisions. Section 901(b) states that a class action "may not be maintained"; Rule 23 states that a class action "may be maintained." To a formalist, this unambiguous language creates a conflict that cannot—and should not—be explained away. Justice Scalia declares that the Court cannot rewrite the text of the statute "to reflect our perception of legislative purpose"—an unambiguously formalist position. [56] He also predicts that attempting to decipher the state legislature's intent from sources other than enacted text is "destined to produce 'confusion worse confounded'"—another formalist staple.[57] Finally, he expresses concern that rewriting Section 901(b) would create a rule that district court judges would find difficult to implement because they "have to discern in every diversity case, the purpose behind any putatively pre-empted state procedural rule, even if its text squarely conflicts with federal law."[58] This would "condemn" federal judges to the unsavory task of "poring through state legislative histories," which may be "less easily obtained, less thorough, and less familiar than its federal counterpart."[59] This prediction—that the difficulty in implementing a pragmatic approach will outweigh the gains in interpretive accuracy that such an approach can sometimes yield—is another core formalist tenet.

The dissent, in contrast, attacks the formalist majority in an exasperated paean to pragmatism. Chiding the majority's "mechanical," "insensitive," and "relentless"[60] reading, Justice Ginsburg decries its myopic focus on text. To Justice Ginsburg,

the intent of the New York legislature is obvious: it wanted to preclude the recovery of statutory penalties in class actions. To accomplish that purpose, it drafted Section 901(b) to state that claims for statutory penalties could not be maintained as a class action. It could have equally drafted it to state that statutory penalties could not be recovered in a class action. This latter phrasing would accomplish precisely the same result, and it would also clearly be an enforceable substantive limit on remedies in diversity cases brought under Federal Rule 23. That the legislature failed to word the law with the particularities of *Hanna* and *Erie* in mind should make no difference. Instead, what should drive the Court's interpretation are all the adverse consequences of the majority's needlessly formalist approach: New York's regulatory policy is now "thwarted,"[61] every state has been denied the power to limit monetary awards in federal diversity cases,[62] and *Erie*'s federalism grounding has been eroded.[63] In addition, the majority's decision has produced substantial variations in judgments awarded under Section 901(b), depending on whether the case was litigated in federal or state court, and thus will lead to forum-shopping.[64] Rather than send the case back to the federal district court to proceed as a class action—and make the New York legislature scramble to re-word a decades-old statute—the Court should have given force to Section 901(b) and allowed the "narrow settlement of this particular dispute."[65]

Justice Stevens takes an interpretive middle ground in his concurrence. He agrees with the dissent that legislative history should not be completely out of bounds. But he maintains that legislative history will rarely override the interpretation of a state law that is procedural on its face. As Justice Steven sees it, district courts must interpret federal rules with "some degree of 'sensitivity to important state interests and regulatory policies.'"[66] This is a "tricky balance" that turns on "whether the state law actually is part of a State's framework of substantive rights or remedies."[67] A state procedural rule may be "so bound up with the state-created right or remedy that it defines the scope of that substantive right or remedy."[68] Thus, "[w]hen a State chooses to use a traditionally procedural vehicle as a means of defining the scope of substantive rights or remedies, federal courts must recognize and respect that choice."[69] Justice Stevens rejects Justice Scalia's argument that looking into the intent behind the state law would create difficulties for district courts, stating that the question "is not what rule *we* think would be easiest on federal courts."[70] Rather, the question is what Congress established when it passed the Rules Enabling Act: "Although, Justice Scalia may generally prefer easily administrable, bright-line rules, his preference does not give us license to adopt a second-best interpretation of the Rules Enabling Act."[71] Justice Stevens summarizes his measured formalism in one cutting line: "Courts cannot ignore text and context in the service of simplicity."[72] Applying this rule, Justice Stevens concludes that the text of Section 901(b) is so clearly procedural in nature that it must fall to Rule 23.[73]

IV. Which Approach Is Empirically Justified?

So who has the better approach in *Shady Grove*, the formalists or the pragmatists? Sunstein argues that formalism "must be defended by empirical claims about the likely performance and activities of courts, legislatures, administrative agencies, and private parties" and proposes three ways to measure formalism's application: first, "whether a formalist or nonformalist judiciary will produce more mistakes and injustices"; second, "whether the legislature will anticipate possible mistakes or injustices in advance, and whether it will correct them after they occur, and do so at relatively low cost"; and third, "whether a nonformalist judiciary will greatly increase the costs of decision, for courts, litigants, and those seeking legal advice, in the process increasing the costs associated with unpredictability."[74] The same could equally be said of pragmatism. In Sunstein's framework, "the ultimate issue is what interpretive strategy will create lower costs of decision and costs of error," where the term "cost" is understood to mean "the real-world difficulties—in terms of unpredictability of outcomes—that might follow from one or another interpretive strategy."[75] Sunstein characterizes "decision costs" as costs faced by courts when the attempt to discern the legal rule in deciding a case and costs faced by potential litigants and litigants who have to pay lawyers to figure out the content of the law.[76] Error costs, on the other hand, "involve both the number of mistakes and the magnitude of mistakes."[77]

Shady Grove is a compelling case study for applying Sunstein's proposed method because both authoring justices supported their positions with empirical claims about the consequences of their approaches. Justice Ginsburg's pragmatic approach would have created several types of decision costs. First, the dissent's approach would have complicated the analysis of whether any given state statute regulating penalties in a class action would be preempted by Rule 23. Respondent Allstate noted in its briefing to the Court that many existing laws prohibit class actions, like Section 901(b).[78] Under a pragmatic approach, parties would have to litigate in each instance whether indications that the legislature intended the law to be substantive were sufficiently clear to outweigh its facially procedural appearance.[79] This would lead to high decision costs for litigants on both sides, not to mention the district court at issue. Second, a pragmatic approach would postpone the date when the governing rules would be certain by making it unclear whether any given state statute would be enforced. State legislatures would have little incentive to act until a court battle had been litigated and either won or lost. In the meantime, the law would remain unclear. Although it is difficult to quantify with any precision the decision costs that would have been incurred had the dissent's pragmatic approach prevailed, it is safe to say that they would have been considerable.

It is not clear that Justice Steven's more measured approach—which is the rule of the case—will result in fewer decision costs than those that would have been incurred had the dissent prevailed. His approach requires district courts to give at least some consideration of a state law's legislative history when deciding whether it is "so intertwined with a state right or remedy that it functions to define the scope of the state-created right.[80] But he also emphasizes that "the bar for finding an Enabling Act problem is a high one," and largely gives the legislative history of Section 901(b) the back of his hand, noting that "[t]he mere possibility that a federal rule would alter a state-created right is not sufficient. There must be little

doubt."[81] Thus, while Justice Stevens' rule leaves an opening for the consideration of legislative history in determining whether a applying a Federal Rule would "effectively" violate the Enabling Act, his analysis of Section 901(b) establishes that district courts should set aside the Federal Rule only in extraordinary circumstances.[82]

In contrast to Justice Ginsburg's and Justice Stevens' insistence that the legislative history should play at least some role in deciding how to interpret state laws that facially conflict with Federal Rules, the plurality insists that a direct conflict between a Federal Rule and a state law requires the application of the Federal Rule. This rule would have created three positive results that would have increased certainty and reduced decision costs. First, it would have simplified the analysis district courts must undergo in applying state laws in diversity cases, creating long-term stability and consistency in how the preemption inquiry is applied. Second, it would have provided state legislatures with a road map for how to draft statutes limiting penalties that will be enforced. Third, it would have created certainty for litigants, who face little or no ambiguity regarding the terms under which they will be allowed to proceed with state claims involving Federal Rule 23 under the diversity statute. Together, these results would have reduced the costs of decision for courts, litigants, and people seeking legal advice over the long term.[83] In addition, state legislatures would have had an incentive to immediately amend any laws that facially conflict with Federal Rule 23.

But decision costs are only part of the calculus. As the dissent emphasizes, the plurality's formalist approach—and the concurrence's measured formalist approach as applied in this case—will increase forum-shopping and will foster divergent outcomes between state—and federal-court litigation of claims brought under the exact same law—a contention neither the concurrence nor the plurality disputes.[84] In addition, in at least some cases involving existing state statutes, the formalist approach has the cost of denying effect to what the state legislature plainly intended to accomplish—which is a serious cost of the approach, albeit one that is again difficult to quantify.

V. Concluding Observations

In our view, the formalist majority has the better of the argument in *Shady Grove*. Its rule provides long-term stability and certainty at the cost of a relatively small number of decisions in the short term that may allow statutory penalties to be recovered in a class action, contrary to the state legislature's original intent. This cost will linger only as long as it takes state legislatures to revise their codes to regulate remedies directly instead of regulating them indirectly by manipulating the rules of class certification. The cost may be even lower if state legislatures are able to make their revisions retroactive, a question we think is interesting but do not attempt to answer here.

One final note is that, although *Shady Grove* necessarily provides the most information about the interpretive approaches of the authoring Justices, it also provides information about the Justices who joined the respective sides as well. Justice Sotomayor, who voted to allow class actions to proceed, did so by joining the formalist plurality rather than Justice Stevens' more pragmatic concurrence. But she refused to join the portions of the plurality deriding Justice Stevens' analysis. To us, her vote indicates some formalist inclinations to limit the interpretive discretion afforded to federal district court judges, but it also indicates some unwillingness to attack her new colleagues in print—which suggests a distinct pragmatism of its own.

Endnotes

1 130 S. Ct. 1431 (2010).

2 Posting of Daniel Fisher to On The Docket Blog, http://blogs.forbes.com/docket/2010/03/31/ stop-the-presses-scalia-defends-class-actions/ (Mar. 31, 2010, 11:55 EST).

3 Amchem Prods., Inc. v. Windsor, 521 U.S. 591, 617 (1997) (quoting Benjamin Kaplan, *A Prefatory Note*, 10 B.C. Indus. & Com. L. Rev. 497, 497 (1969)).

4 130 S. Ct. at 1460 (Ginsburg, J., dissenting).

5 Fisher, *supra* note 2.

6 *See* 130 S. Ct. at 1437.

7 *Id.* at 1436-37.

8 CAFA jurisdiction was proper because the alleged class had more than 100 members, at least one plaintiff and one defendant were diverse, and the aggregated damages of the alleged class—calculated according the New York's statutory interest statute—exceeded $5,000,000. *See* 28 U.S.C. § 1332(d)(2), (4). If Shady Grove had proceeded only on its own behalf, its individual damages of $500 would not have satisfied the amount in controversy requirement of the diversity statute. *See* 28 U.S.C. § 1332(a).

9 The New York law at issue was enacted in 1975 and Federal Rule 23 has existed in its current form since 1966. But the preemption question in *Shady Grove* arose only after the enactment of the Class Action Fairness Act of 2005, which provides federal jurisdiction over putative class actions raising state-law claims, provided they meet the criteria specified in note 8, *supra*. Before CAFA, the amount in controversy requirement could not, as a general rule, be satisfied by aggregating the claims of the putative class members. *See, e.g.,* Gilman v. BHC Sec., Inc., 104 F.3d 1418, 1422 (2d Cir. 1997). Thus, in cases where each named plaintiff had a small, distinct claim under laws like Section 901(b), the amount in controversy could not be met, precluding federal jurisdiction.

10 Shady Grove Orthopedic Assocs. v. Allstate Ins. Co., 466 F. Supp. 2d 467 (E.D.N.Y. 2006).

11 Shady Grove Orthopedic Assocs. v. Allstate Ins. Co., 549 F.3d 137, 145 (2d Cir. 2008).

12 304 U.S. 64 (1938).

13 380 U.S 460 (1965).

14 28 U.S.C. § 1652 ("The laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply.").

15 28 U.S.C. § 2072 ("The Supreme Court shall have the power to prescribe general rules of practice and procedure and rules of evidence for cases in the United States district courts (including proceedings before magistrate judges thereof) and courts of appeals. . . . Such rules shall not abridge, enlarge or modify any substantive right.").

16 *See* Shady Grove Orthopedic Assocs. v. Allstate Ins. Co., 130 S. Ct. 1431, 1437 (2010); *id.* at 1448-49 (Stevens, J., concurring in part and concurring in the judgment); *id.* at 1460-63 (Ginsburg, J., dissenting).

17 *Id.* at 1460-61 (Ginsburg, J., dissenting).

18 In *Erie* the Court considered "the constitutional power of federal courts

to supplant state law with judge-made rules." 130 S. Ct. at 1442; *see* Erie v. Tomkins, 304 U.S. 64, 78 (1938). ("Except in matters governed by the Federal Constitution or by acts of Congress, the law to be applied in any case is the law of the state.").

19 130 S. Ct. at 1461 (Ginsburg, J., dissenting) (quoting 28 U.S.C. § 2072).

20 Hanna v. Plumer, 380 U.S. 460, 470 (1965).

21 130 S. Ct. at 1448 (Stevens, J., concurring in part and concurring in the judgment).

22 *Id.* at 1437.

23 *Id*.

24 *Id.*

25 *Id*.

26 *Id*.

27 *Id.* at 1438.

28 *Id.* at 1439.

29 *Id.*

30 *See id.* at 1466.

31 *Id.*

32 *Id*.

33 Justice Stevens' concurrence provides the holding of the Court. *See* Marks v. United States, 430 U.S. 188, 193 (1977) ("When a fragmented Court decides a case and no single rationale explaining the result enjoys the assent of five justices, the holding of the Court may be viewed as that position taken by those Members who concurred in the judgments on the narrowest grounds.") (internal quotation marks omitted).

34 130 S. Ct. at 1456 (Steven, J., concurring in part and concurring in the judgment).

35 *Id.* at 1451 (quoting Burlington N. R.R. Co. v. Woods, 480 U.S. 1, 5 (1987)).

36 130 S. Ct. at 1451 (Steven, J., concurring in part and concurring in the judgment). *See also* 28 U.S.C. § 2072.

37 130 S. Ct. at 1449 (Steven, J., concurring in part and concurring in the judgment).

38 *Id.* at 1452.

39 *Id.* at 1459.

40 *Id.* at 1461 (Ginsburg, J., dissenting).

41 *Id.* at 1463 (quoting Gasperini v. Ctr. for Humanities, Inc., 518 U.S. 415, 427 n.7 (1996)).

42 130 S. Ct. at 1464 (Ginsburg, J., dissenting).

43 *Id.* at 1468 n.10.

44 *Id.* at 1473.

45 *See, e.g.,* David L. Franklin, *Justice Ginsburg's Common-Law Federalism*, 43 New Eng. L. Rev. 751 (2009); Russell A. Miller*, Clinton, Ginsburg, and Centrist Federalism*, 85 Ind. L.J. 225 (2010).

46 531 U.S. 98 (2000).

47 *See, e.g.,* Empire Healthchoice Assurance, Inc. v. McVeigh, 547 U.S. 677 (2006).

48 Because the Court's holding is articulated by Justice Stevens' concurrence, the lineup of votes suggests that the case could have come out differently had it come before the Court in the October 2010 Term, after Justice Stevens' retirement.

49 Cass R. Sunstein, *Must Formalism be Defended Empirically?*, 66 U. Chic. L. Rev. 636, 638 (Summer 1999).

50 *Id.* at 638-39.

51 *Id.* at 639.

52 Richard A. Posner, Law, Pragmatism, and Democracy 59 (2003).

53 Richard A. Posner, The Problems of Jurisprudence 73 (1990).

54 Sunstein, *supra* note 49, at 640.

55 Antonin Scalia, A Matter of Interpretation (1997).

56 Shady Grove Orthopedic Assocs. v. Allstate Ins. Co., 130 S. Ct. 1431, 1440 (2010).

57 *Id.* at 1441-42 (quoting Sibbach v. Wilson & Co., 312 U.S. 1, 14 (1941).

58 130 S. Ct. at 1441.

59 *Id.*

60 *Id.* at 1464, 1467 n.7, (Ginsburg, J., dissenting).

61 *Id.* at 1464.

62 *Id.* at 1468.

63 *Id.* at 1473.

64 *Id.* at 1471-72.

65 Sunstein, *supra* note 49, at 638.

66 130 S. Ct. at 1449 (Stevens, J., concurring in part and concurring in the judgment) (quoting Gasperini v. Ctr. for Humanities, Inc., 518 U.S. 415, 427 n.7 (1996)).

67 130 S. Ct. at 1449 (Stevens, J., concurring in part and concurring in the judgment).

68 *Id.* at 1450.

69 *Id*.

70 *Id.* at 1454.

71 *Id*.

72 *Id*.

73 *Id.* at 1459-60.

74 Sunstein, *supra* note 49, at 641.

75 *Id*. at 641-42.

76 *Id.* at 647.

77 *Id.*

78 Brief for Respondent Allstate Insurance Company at 42, Shady Grove Orthopedic Assocs. v. Allstate Ins. Co., 130 S. Ct. 1431 (2010).

79 Of course, the dissent's proposed rule would have applied not only to state laws that facially conflict with Rule 23, but all state laws that facially conflict with any Federal Rule.

80 130 S. Ct. at 1452 (Stevens, J., concurring in part and concurring in the judgment).

81 *Id.* at 1457.

82 *See id.* at 1451-52.

83 *See* Sunstein, *supra* note 49, at 641.

84 130 S. Ct. at 1447-48 (plurality opinion); *see id.* at 1456-57 (Stevens, J., concurring in part and concurring in the judgment).

Professional Responsibility & Legal Education

Should the Public Be Able to Buy Stock in Law Firms?

*By Thomas D. Morgan**

The current economic downturn has been a wake-up call for lawyers. A profession that thrived on working by the hour in a market based on closing multiple deals has seen much of that work disappear. Over 4,000 American lawyers, many of them equity partners, were terminated by U.S. law firms last year, while new lawyers often found their lucrative job offers "deferred" to an uncertain future date.[1] It is not hard to finance law firm growth when each new associate a law firm hires can support billings at two or three times what she is paid. It is harder to finance a firm through the inevitable swings of good and not-so-good economic fortune.

In May 2007, Slater & Gordon, an Australian law firm concentrating in personal injury practice,[2] listed itself on the Australian stock exchange. Doing so violated one of the legal profession's deep taboos—the prohibition against selling ownership interests in a law firm to non-lawyers. But lest this seem a unique event, the Legal Services Act of 2007 has similarly opened U.K. law firms to the world of "alternative business structures," including non-lawyer owners,[3] and when the law takes effect later in 2010, several UK law firms appear poised to accept outside investors.[4]

The United States, on the other hand, has not yet embraced the idea of non-lawyers taking an equity stake in a law firm. All American jurisdictions have some form of ABA Model Rule 5.4(d) that says:

> A lawyer shall not practice with or in the form of a professional corporation or association authorized to practice law for a profit, if (1) a nonlawyer owns any interest therein . . .; (2) a nonlawyer is a corporate director or officer thereof or occupies the position of similar responsibility . . .; or (3) a nonlawyer has the right to direct or control the professional judgment of a lawyer.

This article will argue that the American restriction on non-lawyer investment in law firms is obsolete, counterproductive, and not justified by any reasonable regulatory or ethical concerns.[5]

While today's law partnerships can have many members, they are traditionally simple business organizations. Even when the law firm is organized other than as a general partnership—as a limited liability company, for example—lawyers usually contribute a defined sum of equity capital at the time they reach the equivalent of partnership status and they typically receive a comparable sum back when they retire or withdraw.

While partnership agreements vary, U.S. lawyers traditionally have not put a value on the "good will" in their firms, in part because to do so would imply the firms can be sure that clients will continue to retain it.[6] Any capital required to build out office space, buy furniture and new technology, stock the library, guarantee a lease, or otherwise provide working funds traditionally has been borrowed from the partners or from banks.[7]

Given a history of law firm finance that has seemed to work for generations, a natural question might be why law firms would want to raise equity capital from third parties at all. One answer is obviously that it is human nature to want to take risks using other people's money and taking on debt means retaining risk, while equity seems to shift it. Equity capital can be relatively expensive, however, because one has to share profits, not just pay interest.[8] Ordinarily, one only seeks outside capital at all when the projected return is likely to exceed the cost, and in a world of low interest rates, borrowed money has long looked like the way to keep all law firm profits in the hands of the lawyer-partners.

But there are at least three reasons why law firm interest in selling equity seems to be growing. First, law firms have long paid profits out each year rather than retaining earnings. The partners in many firms have learned to like the short-term lifestyle such a practice supports, but the result is to make money less available or more costly for long-term investments in new technology, new offices, or to support an expanded scope of practice.

The Australian and U.K. experience tends to confirm this explanation. Slater & Gordon, for example, reported a need to consolidate several offices into larger ones and a need to finance high litigation expenses between the time a case is filed and the time the fee becomes payable. In the U.K., it seems to be mid-size firms that want to expand their ability to use technology to deliver commodity services to middle class clients that may be especially hungry for capital.

A second reason for a law firm's turning to non-lawyer investors will be to create a liquid market in firm shares so that good will can be priced and departing partners can realize full value for their years of service. Successful managers in other industries receive stock options, the argument goes. They profit when the company profits and they pay taxes at capital gain rates on the increase in their share value.[9] Lawyers and law firm managers, on the other hand, basically receive only a pass-through of fees earned that is taxed at high ordinary-income marginal rates.

A third incentive for seeking non-lawyer investment may be to create a more lasting institutional character to the modern law firm and to encourage the development of the firm's brand identity and its reputation for ethics and quality.[10] A law firm's principal assets—its partners and associates—walk out the firm's door every day, have no obligation to return, and often get no

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more or less in return of their capital investment if they have helped the firm prosper or simply get by. [11]

In such an environment, even equity partners have little personal stake in the firm as an institution, other than not to be left holding the bag if the firm fails. When outside investors are involved, on the other hand, there are parties with a genuine stake in the institution's growth and prosperity. And the incentives flow to the lawyers as well. The best way to get people to devote full effort to their law practice, the argument goes, is to give them something tangible to show for their efforts when the time comes to leave.

But if there are legitimate reasons for seeking outside investors, why have lawyers so long resisted the idea? The first reason is probably historical. Until the late 1960s, law firms tended to be quite small. In 1968, for example, only twenty U.S. law firms had over 100 lawyers.[12] In a small firm, personal relationships provide bonding and incentives for firm survival that outside investors might do little to augment. Further, few outside investors would likely have wanted to put their money into such small operations. In short, until recent years, there was more disinterest than opposition to the subject of outside investment in law firms.

But for those who did think about the issue, one concern was that lawyers are their clients' agents and have a fiduciary duty to focus principal attention on their clients' interests. Law firms exist to help lawyers provide that kind of fiduciary attention. Admitting non-lawyer investors to the mix will create a competing interest in earning a high economic return, the argument goes, thus potentially compromising the interests of clients or even influencing the lawyers' professional judgment of how to represent the clients.

A somewhat related concern is that shareholders who are not firm lawyers will inevitably expect information about the firm and its clients, if only to measure management success and to predict future firm performance. Confidential client information is something a lawyer must keep inviolate.[13] Even a client's identity is normally not public information and may not be disclosed other than when doing so would be in the client's interest. Market information, on the other hand, is essential and the inherent tension over its release may seem to place insurmountable limits on sale of equity securities.

A different concern is that the involvement of non-lawyer investors would reduce lawyers' willingness to tell clients what the clients don't want to hear. The last time a serious effort was made to bring law firms into modernity by opening them up to non-lawyer partners, the Enron scandal broke in which lawyers were accused of turning a blind eye to wrongdoing by Enron executives. Critics largely ignored the fact that the Enron events took place under the current regime, not one involving non-lawyers, but the critics suggested the events might have turned out even worse if profit-making rather than client service became a law firm's touchstone.

Related to the last point, concern is sometimes heard that firms with private investors would invest too little in assuring that lawyers see law as having a public element. It is by now a commonplace that private lawyers engage in more law enforcement than regulators do. It is private lawyers who candidly tell clients what conduct is likely to get them into legal trouble and thus prevent the clients from violating the law in the first place. Putting a profit motive into law practice, the argument goes, will reduce lawyers' sense of their "officer of the court" role and lead to a decline in their clients' sense of public obligations.[14]

Finally, many lawyers seem to have a recurring nightmare of waking up working for Walmart. One of the early proposals when the ABA Model Rules were proposed in 1983 was that the barrier against lawyers practicing with non-lawyers be breached. Geoffrey Hazard, reporter to the ABA Commission was asked: "Does this mean Sears & Roebuck will be able to offer a law office?" When Hazard answered "yes," the proposal was defeated. Lawyers working for non-lawyers, it seemed, would be demeaning and thus unprofessional.[15]

The answers to these objections, of course, are not hard to see. First, the idea that only outside investors have a profit motive ignores the history of large law firms over the last forty years. Profits have been widely publicized in the *American Lawyer* and elsewhere.[16] They have been the lure to attract new lawyers, the incentive to work evenings and weekends, and the measure of many lawyers' self-worth. The presence of outside investors may change how profits are shared but not whether profits are sought.

Second, there is nothing about doing well as a lawyer that inhibits doing good work for clients or helping them obey the law. Most clients, most of the time, want help to stay out of trouble, not figure out how to violate legal standards. Clients sometimes may want to move the law in directions that outside observers would not favor, but that difference in viewpoint neither makes their lawyers less civic-minded nor likely has anything to do with whether a firm has issued equity capital.[17]

Third, most of the talk today is about firms seeking private capital from sophisticated investors rather than selling publicly-traded stock as Slater & Gordon did. While one could imagine law firms doing the kind of financial reporting that the SEC requires, it would likely be more trouble than it is worth, and reducing the number of investors actually involved would tend to reduce the amount of even non-sensitive client information that would be made available.

Finally, lawyers are likely to have to get over the fear of Walmart. Most lawyers do not provide services to Walmart customers or other middle class clients today. Those potential clients represent a possible growth market for lawyers, however, and a potential unmet demand. At least the start-up costs to do that kind of work will require the kind of capital that outside investors might provide, and Walmart and other mass merchandisers seem as good a source of capital as any.

The more serious practical question is whether anyone who is well-informed would decide to invest in a law firm. Published reports of several million dollars in earnings per partner may make the investment look attractive, but there are real potential risks. Clients tend to shop for individual lawyers today, at least as often as they shop for particular firms. Investing in institutions that have no control over their human assets may prove shortsighted and not nearly as profitable as some investors imagine.[18]

Further, investment in law firms is not a hedge against market downturns. The best predictor of how busy lawyers will be is how busy their clients are. As the economy rebounds, lawyers will do better, but law practice activity tends to lag economic recovery, not lead it. Stock in a law firm, in short, will tend to track most other business investments, not hedge or otherwise complement them.

Whether or not non-lawyer investment in law firms is wise as an investment strategy, however, is largely beside the point. The practice of allowing non-lawyer investment in law firms has the potential of providing a genuine economic benefit and a low risk of public harm. If not an idea whose success is inevitable, it's at least not an idea to dismiss out of hand.

Endnotes

1 See, e.g., Thomas D. Morgan, The Vanishing American Lawyer 2-3 (2010).

2 Information about Slater & Gordon can be found at http://www.slatergordon.com.au.

3 For background on these developments, see, e.g., Ted Schneyer, *Thoughts on the Compatibility of Recent U.K. and Australian Reforms with U.S. Traditions in Regulating Law Practice*, 2009 J. Prof. Law. 13.

4 *See, e.g.,* Charlotte Edmond, Private Equity Firm First to Openly Target Legal Services in U.K., http://www.law.com/jsp/law/LawArticleFriendly.jsp?id=900005560588 (reporting on the plans of investment house Lyceum Capital, whose advisory board includes Richard Susskind, IT advisor to the Lord Chief Justice, and Tony Williams, former director of Andersen Legal, the legal arm of the late-Arthur Andersen accounting firm).

5 One of the early articles considering these issues was Edward S. Adams & John H. Matheson, *Law Firms on the Big Board: A Proposal for Nonlawyer Investment in Law Firms*, 86 Calif. L. Rev. 1 (1998).

6 ABA Formal Opinion 266 (1945) put the matter dramatically: "Clients are not merchandise. Lawyers are not tradesmen. They have nothing to sell but personal service. An attempt, therefore, to barter in clients, would appear to be inconsistent with the best concepts of our professional practice."

7 *See, e.g.,* Morgan, *supra* note 1, at 166-67.

8 Professor Larry Mitchell has usefully documented the relatively infrequent use of equity capital to fund capital needs in Lawrence E. Mitchell, Who Needs the Stock Market, Part I: The Empirical Evidence (2008), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1292403.

9 The point is developed by Bruce MacEwen in Bruce MacEwen, Milton C. Regan, Jr., & Larry Ribstein, *Conversation: Law Firms, Ethics & Equity Capital*, 21 Geo. J. Legal Ethics 61 (2008).

10 *See, e.g.,* Morgan, *supra* note 1, at 169-70.

11 A law firm may not restrict any lawyer's right to practice elsewhere, except as a condition of receiving retirement benefits. Model rules of Prof'l Conduct R. 5.6(a).

12 Morgan, *supra* note 1, at 99-101.

13 Model rules of Prof'l Conduct R. 1.6(a).

14 The argument is offered by Professor Mitt Regan in Bruce MacEwen, Milton C. Regan, Jr., & Larry Ribstein, *Conversation: Law Firms, Ethics & Equity Capital*, 21 Geo. J. Legal Ethics 61, 70-72 (2008).

15 *See, e.g.,* Thomas D. Morgan & Ronald D. Rotunda, Professional Responsibility: Problems & Materials 614 (8th ed. 2003).

16 *See, e.g.,* Aric Press & John O'Connor, *The Law Firm Investor's Guide*, Am. Law., June 2008, at 121 (offers growth and blue-chip indexes to law firms during the days of high law firm profitability).

17 Bruce MacEwen has offered an imaginative alternative of a derivative security priced to reflect financial performance of the law firm but that would give the security holder no management control. *See* Bruce MacEwen, Milton C. Regan, Jr., & Larry Ribstein, *Conversation: Law Firms, Ethics & Equity Capital*, 21 Geo. J. Legal Ethics 61, 64-67 (2008). Professor Regan is likely correct that those who oppose outside investment would not be impressed by the distinction, *id.* at 67-70, but it is a possible middle ground.

18 *See, e.g.,* Larry E. Ribstein, The Death of Big Law, University of Illinois Law & Economics Research Paper No. LE09-025 (2009), *available at* http://ssrn.com/abstract=1467730 (predicting that large law firms will have little real reason to hold themselves together).

The Montana Supreme Court Legalizes Assisted Suicide

*By William L. Saunders**

"In almost every State—indeed, in almost every western democracy—it is a crime to assist a suicide. The State's assisted-suicide bans are not innovations. Rather, they are longstanding expressions of the State's commitment to the protection and preservation of all human life."[1]

A dozen years after the United States Supreme Court penned this passage in *Washington v. Glucksberg*, Montana became the third state where physician assisted suicide is "legal." However, it is the first state where this change occurred as a result of a court decision, as opposed to legislative action.

In *Baxter v. State*, decided December 31, 2009, the Montana Supreme Court did not "constitutionalize" a "right to die" as the lower court had done. Rather, the court held that physicians who prescribe lethal drugs upon the request of their patients are not subject to criminal liability under the "consent defense" to Montana's homicide law. Thus, technically, the court did not "legalize" assisted suicide; rather, someone who assists a suicide simply has a "defense" to homicide.

However, resting its reasoning on statutory grounds has not immunized the Court opinion from criticism. The consent defense to homicide is not applicable if such a defense would be against public policy. Thus, permitting a consent defense to a charge of assisting suicide, the court found there was no public reason against it. Doing so, it did not discuss some evidence to the contrary. Further, the decision does not preclude a future state constitutional challenge should the Montana legislature enact legislation clarifying that its law and policy do not permit physician assisted suicide.

I. Background of Baxter

In *Baxter v. State*, the named plaintiffs, two patients and four physicians,[2] sought to "establish their constitutional rights, respectively, to receive and provide aid in dying."[3] The plaintiffs' complaint defined "aid in dying" as "involv[ing] the right of a mentally competent, terminally ill adult patient to obtain a prescription for medication from a cooperating doctor, which the patient may choose to take to hasten an inevitable death in the face of unrelenting pain and misery at the end of life."[4]

The plaintiffs argued that rights granted by the Montana Constitution of privacy, individual dignity, due process, equal protection of the law, and the right to seek "safety, health and happiness in all lawful ways" guaranteed the right to "aid in dying."[5]

Robert Baxter, a named plaintiff, was a seventy-five-year old retired truck driver. He suffered from lymphocytic leukemia with diffuse lymphadenophathy, a form of cancer.[6] Lymphocytic leukemia is treated with multiple rounds of chemotherapy that become less effective over time. There is no known cure for the disease.

A second plaintiff in the case was Steven Stoelb. The complaint alleged Mr. Stoelb was terminally ill with Ehlers-Danlos Syndrome ("EDS").[7] There is no known cure for EDS. However, it is not a terminal illness.[8] Though Mr. Stoelb withdrew from the case as a party plaintiff because "during the hearing it became apparent that Mr. Stoelb's condition presented a contested issue of material fact," his initial inclusion as a plaintiff underscores the point that while the pleadings claim this "right" for the terminally ill, the "right" cannot be logically limited to those suffering *terminal* illnesses.

Suicide is not a crime in Montana. Neither Mr. Baxter, nor Mr. Stoelb, nor their estates would have been charged with any crime in Montana had they committed suicide.

The physician who prescribed a lethal drug for the plaintiffs could have faced criminal prosecution, however. Under Section 45-5-102, MCA, a person who purposely or knowingly causes the death of another human being in Montana commits the offense of deliberate homicide. Conduct is deemed the cause of another's death if the defendant's acts were committed purposely or knowingly, and the death would not have occurred without them.[9] Thus, a physician intentionally providing a lethal prescription could be prosecuted and convicted of homicide.

II. No Federal Right to Assisted Suicide

In 1997, the United States Supreme Court in *Washington v. Glucksberg*[10] and its companion case *Vacco v. Quill*[11] held that there is no right to assisted suicide under the Federal Constitution.

In *Glucksberg*, the plaintiffs challenged Washington State's assisted suicide ban. The Court was asked whether "liberty," specially protected by the United States Constitution, included a "right" to assisted suicide.[12] The Supreme Court found no such right, but rather a "consistent and almost universal tradition that has long rejected the asserted right and continues to explicitly reject it today, even for terminally ill, mentally competent adults."[13] The Court said finding a "right" to assisted suicide would "reverse centuries of legal doctrine and practice, and strike down the considered policy choice of almost every State."[14]

Advocates of assisted suicide and euthanasia often argue for their legalization because they are "deeply personal" choices. However, as the Supreme Court wrote in *Glucksberg*, "the decision to commit suicide may be just as personal and profound as the decision to refuse unwanted medical treatment, but it has never enjoyed similar legal protection. Indeed, the two acts are widely and reasonably regarded as quite distinct."[15]

Seven years earlier, in the case *Cruzan v. Director, Missouri Department of Health*, the United States Supreme Court held that "refusing life-sustaining medical treatment" was a protected

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interest.[16] In *Glucksberg*, the Court explained *Cruzan* "was not simply deduced from abstract concepts of personal autonomy." Rather, it was based in "the common-law rule that forced medication was a battery, and the long legal tradition protecting the decision to refuse unwanted medical treatment," and was "entirely consistent with this Nation's history and constitutional traditions." However, in *Glucksberg*¸ the Court found that *Cruzan* and "the nation's history" did not support a right to assisted suicide or euthanasia.

The Supreme Court also explicitly rejected the argument that its definition of "liberty" in *Planned Parenthood v. Casey* included, or could be the basis for, a federal right to assisted suicide.[17] The Court stated, "That many of the rights and liberties protected by the Due Process Clause sound in personal autonomy does not warrant the sweeping conclusion that any and all important, intimate, and personal decisions are so protected, and *Casey* did not suggest otherwise."[18] Simply put, under the Court's understanding of liberty and privacy, assisted suicide is not a fundamental right:

> The history of the law's treatment of assisted suicide in this country has been and continues to be one of the rejection of nearly all efforts to permit it. That being the case, our decisions lead us to conclude that the asserted "right" to assistance in committing suicide is not a fundamental liberty interest protected by the Due Process Clause.[19]

III. No Other State Court has Found a "Right" to Assisted Suicide

The Montana Constitution contains a "right to privacy" clause.[20] Courts in three states with constitutions similarly containing an explicit right to privacy have previously considered whether those provisions encompass the right sought in *Baxter*. All three have rejected the argument that a right to assisted suicide is contained in their privacy clauses.

In *Krischer v. Mciver* the Florida Supreme Court upheld the constitutionality of the state's statute prohibiting assisting suicide.[21] The court recognized the state's compelling interest in the preservation of life, preventing the affirmative destruction of human life, the prevention of suicide, and the maintenance of ethical integrity of the medical profession.[22] Likewise, in *Sampson v. State*, the Alaska Supreme Court determined that physician assisted suicide is not a fundamental right.[23] And in *Donaldson v. Lungren*, a California court held that the right to privacy does not create "a shield for third persons who end [the patient's] life."[24]

IV. Lower Court Decision

On December 5, 2008, Judge Dorothy McCarter of Montana district court issued an opinion holding that there was a right to assisted suicide in the Montana Constitution. The district court opinion acknowledged the United States Supreme Court decisions, and those of the Florida, Alaska, and California courts that all rejected the argument that such a right was contained in their constitutions. Judge McCarter, however, held that the Montana Constitution was distinguishable, and a combination of its privacy and dignity clauses mandated a right to assisted suicide.[25] In fact, these two provisions are so clearly intertwined for the court that it is somewhat difficult to separate them for purposes of this analysis.

The dignity clause of the Montana Constitution reads, "The dignity of the human being is inviolable. No person shall be denied the equal protection of the laws."[26] The lower court relied heavily upon one Montana case in particular to expound the meaning of this constitutional provision.

In 2003, in *Walker v. State*, the Montana Supreme Court applied the dignity clause. The case involved the treatment of a prison inmate, and the court quoted the following statement from a Montana Law Review article: "[T]reatment which degrades or demeans persons, that is, treatment which deliberately reduces the value of persons, and which fails to acknowledge their worth as persons, directly violates their dignity."[27]

The lower court concluded that not permitting physician assisted suicide would violate a patient's dignity because

> [i]f the patient were to have no assistance from his doctor, he may be forced to kill himself sooner rather than later because of the anticipated increased disability with the progress of his disease, and the manner of the patient's death would more likely occur in a manner that violates his dignity and peace of mind, such as by gunshot or by an otherwise unpleasant method, causing undue suffering to the patient and his family.[28]

The lower court found that Montana's constitutional right to privacy was also implicated.[29] The Montana Constitution states, "The right of individual privacy is essential to the well-being of a free society and shall not be infringed without the showing of a compelling state interest."[30] Noting the importance of the right to privacy, the *Gryczan v. State*, the Montana Supreme Court explained that "its separate textual protection in our Constitution reflects Montanans' historical abhorrence and distrust of excessive governmental interference in their personal lives."[31]

The lower court cited *Armstrong v. State*, a case challenging the constitutionality of a statute prohibiting certified physician's assistants from performing abortions, as holding that this right includes "the right of each individual to make medical judgments affecting her or his bodily integrity and health in partnership with a chosen health care provider free from the interference of the government."[32] The lower court found the decision to end one's life by assisted suicide to be a similar medical judgment and therefore held that the decision to commit assisted suicide "certainly is one of personal autonomy and privacy."[33]

Thus, the lower court held that the dignity and privacy clauses mandated a right to assisted suicide for "qualified patients":

> Taken together . . . the right of personal autonomy included in the state constitutional right to privacy, and the right to determine "the most fundamental questions of life" inherent in the state constitutional right to dignity, mandate that a competent terminally ill person has the right to choose to end his or her life.[34]

The court concluded that the "right" created by these provisions "necessarily incorporates the assistance of [the patient's] doctor."[35]

Who would be a "qualified patient" was not clearly defined. Lower court pleadings of appellees indicate that anyone who survives on life-sustaining medication would be eligible. Critics point out that this logically includes anyone on blood-pressure medication, diabetics taking insulin, or asthmatics with inhalers.

Furthermore, critics say, the district court opinion does little to address the needs of the depressed. The opinion states that "[c]ompetency is easily determined by the patient's doctor."[36] However, many doctors are not equipped to diagnose and treat depression, and studies show that people requesting suicide are often suffering from this treatable mental illness. The Royal College of Psychiatrists in England observed in 2006 that systematic studies have "clearly shown" the wish for assisted suicide among terminally ill patients is "strongly associated with depression."[37] It concluded that most physicians cannot diagnose (and are thus unable to treat) depression and that ninety-eight to ninety-nine percent of those patients would subsequently change their minds about wanting to die once their depression had been treated. It seems indisputable that patients whose requests for assisted suicide are attributable to untreated clinical depression are not exercising the "autonomous" choice that advocates frequently offer as justification for legalization of physician assisted suicide.

V. Montana Supreme Court Decision

The Montana Supreme Court did not rule on the constitutional question, citing the judicial principle to "decline to rule on the constitutionality of a legislative act if we are able to decide the case without reaching constitutional questions."[38] Instead, it held that the consent defense to homicide "shields physicians from homicide liability if, with the patient's consent, the physicians provide aid in dying to terminally ill, mentally competent adult patients."[39]

The consent defense, however, as noted above, does not apply if it would be against "public policy."[40] The majority opined that there was "no indication" in Montana law that physician assisted suicide is against public policy and therefore no reason not to apply the consent defense. [41]

The court first set out to define what is meant by "against public policy." The court began by concluding that the "against public policy" exception is not limited to cases of aggravated assault. In order to determine whether Montana did have a public policy against assisted suicide, the court then analyzed a Montana statute, the Montana Rights of the Terminally Ill Act (hereafter, the "Act").[42] The Act requires respect for a patient's determination that he does not want to undergo treatment, or that he wants to be removed from life support—a health care provider must follow the patient's directive or transfer the patient to a provider willing to follow the directive.[43]

In its analysis, the court conflated physician assisted suicide with withholding treatment or withdrawing life support. However, the United States Supreme Court has emphasized that, while a request in each instance similarly comes from the patient, what is being requested in physician assisted suicide is different: with a request to withhold treatment, a patient asks that a doctor not prolong dying, but with assisted suicide, a person asks that a doctor provide the tools to bring about death.

The majority centered their analogy between what the Act allows and physician assisted suicide on the fact that these are both "autonomous" requests by a patient.[44] The court stated there is a "very narrow set of circumstances in which a terminally ill patient *himself* seeks out a physician and asks the physician to provide him the means to end his own life."[45] However, the court did not bring up the fact that euthanasia, for example, can also result from a voluntary request, and, as the court admitted, euthanasia is against public policy.[46] Montana does not require physicians to follow all "autonomous" requests by a patient about "end-of-life" scenarios. In the Act, Montana's legislature drew a distinction between letting a patient choose to die of their underlying condition and letting a doctor kill the patient. This distinction may call into question the court's reliance on the Act to support its decision.

VI. The Public Policy Question

While finding that physician assisted suicide was not against public policy, the court did not discuss much evidence that it is.

Not only did the U.S. Supreme Court in *Glucksberg* note there was no basis in history for creating a "right to die," it also identified several state interests against creating such a right. First and foremost, the state has an interest in protecting life.[47] A fundamental purpose of society is mutual protection.

Another reason the court offered to prohibit assisted suicide is "protecting the integrity and ethics of the medical profession."[48] A "right to die" can be seen as converting the medical profession from one of healing to one of killing. As the Supreme Court observed, the policies of multiple medical organizations state that assisted suicide threatens to undermine the fundamental ethical healing directive of the medical profession itself.[49] "[T]he American Medical Association, like many other medical and physicians' groups, has concluded that 'physician-assisted suicide is fundamentally incompatible with the physician's role as healer.'"[50]

Protecting vulnerable groups, "including the poor, the elderly, and disabled persons," is another important state interest identified by the Court in *Glucksberg*. It noted that these groups experience a "real risk of subtle coercion and undue influence in end-of-life situations."[51] The Court then explained that the state's interest goes further than protecting against coercion: "[I]t extends to protecting disabled and terminally ill people from prejudice, negative and inaccurate stereotypes, and 'societal indifference.'"

In *Glucksberg*, the Court also reasoned that "the State may fear that permitting assisted suicide will start it down the path to voluntary and perhaps even involuntary euthanasia." The "expansive reasoning" of the court of appeals decision on appeal in *Glucksberg* "provide[d] ample support" for this fear.[52] The Supreme Court concluded, "Thus, it turns out that what is couched as a limited right to 'physician-assisted suicide' is likely, in effect, a much broader license, which could prove extremely difficult to police and contain."[23]

The Court in *Glucksberg* added evidence about the practice of euthanasia in the Netherlands that supported the state's concern:

> The Dutch government's own study revealed that in 1990, there were 2,300 cases of voluntary euthanasia (defined as "the deliberate termination of another's life at his request"), 400 cases of assisted suicide, and more than 1,000 cases of euthanasia without an explicit request. In addition to these latter 1,000 cases, the study found an additional 4,941 cases where physicians administered lethal morphine overdoses without the patients' explicit consent. Physician-Assisted Suicide and Euthanasia in the Netherlands: A Report of Chairman Charles T. Canady, at 12-13 (citing Dutch study). This study suggests that, despite the existence of various reporting procedures, euthanasia in the Netherlands has not been limited to competent, terminally ill adults who are enduring physical suffering, and that regulation of the practice may not have prevented abuses in cases involving vulnerable persons, including severely disabled neonates and elderly persons suffering from dementia. . . . The New York Task Force, citing the Dutch experience, observed that "assisted suicide and euthanasia are closely linked," and concluded that the "risk of . . . abuse is neither speculative nor distant."[53]

What has been revealed about legalized assisted suicide and euthanasia post-*Glucksberg* adds to the cause for alarm. The Dutch purport to allow euthanasia and assisted suicide only at the "explicit request" of the patient to put an end to "unbearable suffering." But evidence shows the guidelines and limitations have been widely flouted.[54] Sick patients are now urged to let a doctor know if they do *not* wish to be euthanized when they become incompetent.[55]

Dr. Els Borst, the former Health Minister and Deputy Prime Minister who pushed the law through the Dutch Parliament has said, "In the Netherlands, we first listened to the political and societal demand in favor of euthanasia, obviously this was not in the proper order."[56]

Baroness Finlay, a professor of palliative care who opposes the legalization of assisted suicide in Great Britain, notes,

> You have to ask why is it that so many people working in palliative medicine in this country see what is going on in places such as Oregon as being so fundamentally dangerous. The reason is that we are looking after terminally-ill patients day in and day out—and we know how frightened they are.[57]

Conscience Questions

The Montana majority opinion may restrict the conscience rights of healthcare providers who do not want to participate in physician assisted suicide. The court's discussion by its literal words indicates that such a physician is akin to the doctor who fails to follow a patient's request to withhold or withdraw treatment under the Act. Such conduct may be subject to criminal liability.[58]

Conclusion

It is still true that no state supreme court has held that there is a state constitutional right to physician assisted suicide. Yet the decision in *Baxter v. Montana* is not in step with decisions of other federal and state courts. While Montana's legislature may respond with legislation clarifying that assisted suicide is against public policy and intended to be illegal, the court did not close the door to a future state constitutional challenge which argues that the dignity and privacy clauses *do* give a right to assisted suicide.

Endnotes

1 Washington v. Glucksberg, 521 U.S. 702, 710 (1997).

2 The organization "Compassion & Choices" was also a listed plaintiff in the case.

3 Complaint at 1, Baxter v. State, 2008 Mont. Dist. LEXIS 482 (Mont. Dist. Ct. 2008).

4 *Id.*

5 *Id.*

6 *Id.* at 11.

7 *Id.* at 14 ("Mr. Stoelb is terminally ill with Ehlers-Danlos Syndrome ('EDHS').").

8 "Life expectancy can be shortened with the Vascular Type of EDS due to the possibility of organ and vessel rupture. Life expectancy is usually not affected in the other types." Ehlers-Danlos National Foundation, *What is EDS?*, http://www.ednf.org/index.php?option=com_content&task=view&id=1347&Itemid=88888968.

9 Mont. Code Ann. § 45-2-201.

10 521 U.S. 702 (1997).

11 521 U.S. 793 (1997).

12 The plaintiffs described the question before the Court broadly:

> Pointing to *Casey* and *Cruzan*, respondents read our jurisprudence in this area as reflecting a general tradition of "self-sovereignty," and as teaching that the "liberty" protected by the Due Process Clause includes "basic and intimate exercises of personal autonomy," According to respondents, our liberty jurisprudence, and the broad, individualistic principles it reflects, protects the "liberty of competent, terminally ill adults to make end-of-life decisions free of undue government interference."

The Court rejected such a sweeping statement and defined the question more specifically as "whether the protections of the Due Process Clause include a right to commit suicide with another's assistance." *Glucksberg*, 521 U.S. at 724.

13 *Id.* at 723.

14 *Id.*

15 *Id.* at 725. The Court explicates this point in *Vacco* as well: "[T]he distinction between assisting suicide and withdrawing life support, a distinction widely recognized and endorsed by the medical profession, and in our legal traditions, is both important and logical; it is certainly rational." 521 U.S. 793, 800-801 (1997).

16 497 U.S. 261 (1990).

17 The district court and court of appeals had relied on *Casey* in their opinions against the Washington law: "Like the decision of whether or not to have an abortion, the decision how and when to die is one of 'the most intimate and personal choices a person may make in a lifetime,' a choice 'central to personal dignity and autonomy.'" 79 F.3d at 813-814. Respondents in their arguments to the Supreme Court emphasized the following statement in *Casey*: "At the heart of liberty is the right to define one's own concept of existence, of meaning, of

the universe, and of the mystery of human life. Beliefs about these matters could not define the attributes of personhood were they formed under compulsion of the State." Planned Parenthood v. Casey, 505 U.S. 833, 851 (1992).

18 *Glucksberg*, 521 U.S. at 727-28 (citing San Antonio Indep. Sch. Dist. v. Rodriguez*,* 411 U.S. 1, 33-35 (1973).

19 *Id.*

20 Mont. Const. art. II, § 10.

21 697 So. 2d 97 (Fla. 1997).

22 The legislature, however, could possibly craft a law permitting assisted suicide: "We do not hold that a carefully crafted statute authorizing assisted suicide would be unconstitutional." *Id.* at 104.

23 31 P.3d 88 (Alaska 2001).

24 2 Cal. App. 4th 1614, 1622; 4 Cal. Rptr. 2d 59, 63 (1992).

25 "It is also this addition of the personal integrity clause to the privacy clause that distinguishes the analysis in this case from that of the Florida, Alaska, and California decisions." Baxter v. State, 2008 Mont. Dist. LEXIS 482, at 17 (Mont. Dist. Ct. 2008).

26 Mont. Const. art. II, § 4.

27 2003 MT 134, ¶81, 316 Mont. 134 ¶81, 68 P.3d 872, ¶81.

28 Baxter v. State, 2008 Mont. Dist. LEXIS 482, at 19 (Mont. Dist. Ct. 2008).

29 The Montana Supreme Court has not yet addressed application of the dignity clause without the inclusion of other fundamental rights.

30 Mont. Const. art. II, § 10.

31 942 P.2d 112, 125 (Mont. 1997). The district court also cited *Planned Parenthood v. Casey* for the proposition that a "right" to assisted suicide is "a logical extension of the meaning of 'the most intimate and personal choices a person makes in a lifetime' stated by the *Casey* Court." Baxter v. State, 2008 Mont. Dist. LEXIS 482, at 16 (Mont. Dist. Ct. 2008). However, as discussed above, the United States Supreme Court has already explicitly rejected the notion that *Casey* stands for a right to assisted suicide.

32 1999 MT 261, 296 Mont. 361, 989 P.2d 364 at 16.

33 Baxter v. State, 2008 Mont. Dist. LEXIS 482, at 16 (Mont. Dist. Ct. 2008).

34 *Id.* at 17.

35 *Id.* at 19.

36 *Id.* at 22.

37 The Royal College of Psychiatrists, Statement from the Royal College of Psychiatrists on Physician Assisted Suicide (2006), *available at* http://www.rcpsych.ac.uk/pressparliament/collegeresponses/physicianassistedsuicide.aspx.

38 Baxter v. State, 2009 MT 449, at 10 (Mont. 2009).

39 *Id.* at 12.

40 Mont. Code Ann. § 45-2-211(2) states, "Consent is ineffective if: . . . (d) it is against public policy to permit the conduct or the resulting harm, even though consented to."

41 Baxter v. State, 2009 MT 449, at 13 (Mont. 2009).

42 "The Terminally Ill Act expressly immunizes physicians from criminal and civil liability for following a patient's directions to withhold or withdraw life-sustaining treatment. Section 50-9-240, MCA." The Act defines "life-sustaining treatment" as any medical procedure or intervention that "serves only to prolong the dying process." Mont. Code Ann. § Section 50-9-102(9).

43 Mont. Code Ann. § 50-9-206.

44 "There is no indication in the Rights of the Terminally Ill Act that an additional means of giving effect to a patient's decision—in which the patient, without any direct assistance, chooses the time of his own death—is against public policy." Baxter v. State, 2009 MT 449, at 28 (Mont. 2009). "[T]here is no indication in the statutes that another choice—physician aid in dying—is against this legislative ethos of honoring the end-of-life decisions of the terminally ill." *Id.* at 37.

45 *Id.* at 23.

46 "This chapter does not condone, authorize, or approve mercy killing or euthanasia." Mont. Code Ann. § 50-9-205(7).

47 *Glucksberg*, 521 U.S. at 728 (Washington has an "unqualified interest in the preservation of human life.").

48 *Id.* at 731

49 *Id.*

50 American Medical Association, Code of Ethics § 2.211 (1994); *see* Council on Ethical and Judicial Affairs, *Decisions Near the End of Life*, 267 JAMA 2229, 2233 (1992) ("The societal risks of involving physicians in medical interventions to cause patients' deaths is too great."); New York State Task Force on Life and the Law, When Death Is Sought: Assisted Suicide and Euthanasia in the Medical Context 103-109 (1994) (discussing physicians' views).

51 *Glucksberg*, 521 U.S. at 731-32 (citing *Cruzan,* 497 U.S. at 281).

52 For example, that appellate decision noted

> that the "decision of a duly appointed surrogate decision maker is for all legal purposes the decision of the patient himself," that "in some instances, the patient may be unable to self-administer the drugs and . . . administration by the physician . . . may be the only way the patient may be able to receive them," and that not only physicians, but also family members and loved ones, will inevitably participate in assisting suicide.

Glucksberg, 521 U.S. (quoting court of appeals opinion).

53 *Glucksberg*, 521 U.S. at 734.

54 Dutch law has expanded to encompass mental suffering, and authorities have proposed to accept "tired of life" as an indication for euthanasia. John Keown, Considering Physician-Assisted Suicide: An Evaluation of Lord Joffe's Assisted Dying for the Terminally Ill Bill 6 (Care Not Killing Alliance 2006), *available at* http://www.carenotkilling.org.uk/pdf/Keown_report.pdf; *see also* Tony Sheldon, *Dutch Euthanasia Law Should Apply to Patients "Suffering Through Living" Report Says*, 330 Brit. Med. J. 61 (2005). The Dutch Supreme Court declared that a woman's suffering from grief at the death of her two sons qualified her for euthanasia or assisted suicide. John Keown, Euthanasia, Ethics and Public Policy: An Argument Against Legalisation 87, 109, 131 (2002).

55 John Keown, Considering Physician-Assisted Suicide: An Evaluation of Lord Joffe's Assisted Dying for the Terminally Ill Bill 6 (Care Not Killing Alliance 2006), *available at* http://www.carenotkilling.org.uk/pdf/Keown_report.pdf.

56 Dr. Borst's remarks were made in an interview with researcher Dr. Anne-Marie The, who has studied euthanasia for fifteen years, for a book on the history of euthanasia called *Redeemer Under God*.

57 Tom Rawstorne, *The Chilling Truth About the City Where They Pay People to Die*, Daily Mail Online, August 10, 2009, http://www.dailymail.co.uk/debate/article-1205138/The-chilling-truth-city-pay-people-die.html.

58 "Indeed the legislature has criminalized *failure* to act according to the patient's wishes." Baxter v. State, 2009 MT 449, at 27 (Mont. 2009).

Telecommunications & Electronic Media

National Broadband Plan

*By Howard Waltzman**

In February 2009, as part of the American Recovery and Reinvestment Act (the "Recovery Act"), Congress directed the Federal Communications Commission (the "Commission") to develop a National Broadband Plan "to ensure that all people of the United States have access to broadband capability and [to] establish benchmarks for meeting that goal."[1] This initiative originated with a campaign proposal of President Barack Obama to increase access to broadband services. The Recovery Act also included grants to increase broadband deployment and adoption.

Beginning in April 2009, the Commission hosted a series of regional meetings to study the gap, if any, in broadband deployment, and to formulate policies to be included in the National Plan. The Commission concluded its work and published its National Broadband Plan in March 2010.

The Commission did not formally adopt the National Broadband Plan. Instead, it was drafted by Commission staff at the direction of Chairman Julius Genachowski. Chairman Genachowski then sought a "joint statement of support" signed by all five Commissioners in lieu of a formal vote to approve or adopt the plan.

President Obama praised the National Broadband Plan as bringing America to the cusp of a digital era: "America today is on the verge of a broadband-driven Internet era that will unleash innovation, create new jobs and industries, provide consumers with new powerful sources of information, enhance American safety and security, and connect communities in ways that strengthen our democracy."[2] The Obama Administration and the Commission believe their work in implementing the National Broadband Plan will be the driver for building a new digital economy.

I. Background: Understanding Broadband and the Gap in Broadband Adoption

As opposed to "dial-up access" provided over the telephone network, broadband services are dedicated to transmitting large quantities of data specially for Internet access and other computer-based applications. Broadband services are capable of transmitting greater amounts of information, at substantially faster rates, than dial-up services. There are several types of broadband services, including Digital Subscriber Line, cable modem, fiber, wireless, satellite, and Broadband over Powerline.

The Commission acknowledges that private investment and innovation have fostered a vibrant broadband market that now services the large majority of Americans: "Fueled primarily by private sector investment and innovation, the American broadband ecosystem has evolved rapidly. The number of Americans who have broadband at home has grown from eight million in 2000 to nearly 200 million [in 2009]."[3] Approximately ninety-five percent of Americans living in housing units have access to terrestrial, fixed broadband infrastructure.[4]

Nonetheless, the Obama Administration and the Commission start with the assumption that affordable broadband should be ubiquitous, and that the speeds of broadband services should increase exponentially. Despite rapidly increasing access through private sector investment, the Commission contends that nearly 100 million Americans have not adopted broadband at home, even where it is available.[5] The National Broadband Plan also suggests that broadband-enabled health information technology could improve health care and lower medical costs; that broadband permits students to learn academic material faster; that broadband-enabled smart-grids would increase energy efficiency and reduce dependence on foreign oil; and that broadband improves communications among emergency responders.[6] In other words, while the private sector has invested billions of dollars to make broadband available to nearly every American home—and continues to improve the speed and reliability of the networks—Americans have not yet fully realized broadband's potential.

II. National Broadband Plan Recommendations

The National Broadband Plan sets out a series of recommended proposals to be considered by the Commission, Congress, other federal agencies, states, and local governments, each intended to promote broadband deployment and adoption.

A. Competition Policies

The National Broadband Plan includes several proposals to authorize the Commission to evaluate the competitiveness of the broadband market, and even to exercise certain regulatory powers over broadband providers, at least some of which would require new congressional mandates. Because, historically, telecommunications services were provided by monopolies, the Commission has long had broad authority to regulate so-called "common carriers," such as telecommunications carriers, under Title II of the Communications Act.[7] This includes the authority to regulate certain discriminatory practices, and to protect consumers. But the Commission does not have such authority with respect to "information service providers," including broadband providers, which the Commission previously determined, and the U.S. Supreme Court affirmed, not to be common carriers falling under the jurisdiction of Title II.[8] Absent new congressional mandates, Chairman Genachowski has proposed, as described below,[9] to reclassify certain broadband providers as telecommunications carriers subject to regulation under Title II.

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Because, as noted above, nearly every American home already has *access* to broadband services, the Commission posits that lagging participation in certain markets may be the result of prices, lack of choice, or poor service due to a lack of competition. The Commission notes that the large majority of American households have access to two wireline broadband providers.[10] But given the lack of price data available, the Commission was unable to conclude whether a lack of additional competition was distorting prices. The Commission thus proposes to undertake a detailed market-by-market analysis of broadband pricing and competition. In its analysis, the Commission will also have to evaluate the impact of mobile broadband services on pricing and competition.

Similarly, the Commission proposes to require broadband providers to disclose certain pricing and performance information to consumers that is necessary to enable consumers "to choose the best broadband offers in the market."[11] "Increased transparency will incent service providers to compete for customers on the basis of actual performance."[12]

B. Allocation and Use of Spectrum

In order to encourage the deployment of additional wireless broadband capacity, the Commission proposes to make an additional 300 megahertz of spectrum available for wireless broadband in the next five years, and 500 megahertz of spectrum available in the next ten years.[13] The Wireless Association estimates that wireless broadband providers will require an additional 800 megahertz of spectrum in that time.[14]

The Commission notes that, historically, it has taken as many as thirteen years to redeploy spectrum bands to accommodate a new use.[15] If unable to act quickly, the Commission is concerned that a lack of available spectrum would delay the deployment of new services. The Commission therefore proposes that Congress "consider expressly expanding the [Commission]'s authority to enable it to conduct incentive auctions in which incumbent licensees may relinquish rights in spectrum assignments to other parties or to the [Commission]," and "consider granting authority to the [Commission] to impose spectrum fees on license holders."[16] These new authorities, the Commission contends, would enable the agency to quickly and efficiently redeploy spectrum from existing sources.

Because of the limited amount of spectrum available, however, the Commission asserts that it would be obligated to reallocate spectrum currently used for other purposes. The Commission will encourage additional efficiencies in the television broadcast industry to reduce the spectrum currently used, including through the use of new sub-channels, channel-sharing, and incentive auctions.[17] The Commission forecasts that reallocated spectrum could be available for use by wireless broadband providers by 2015.[18]

While this reallocation would ostensibly be voluntary, television broadcasters are wary. "We were pleased by initial indications from [Commission] members that any spectrum reallocation would be voluntary, and were therefore prepared to move forward in a constructive fashion on that basis," stated Dennis Wharton, Senior Vice President of the National Association of Broadcasters.[19] But Wharton asserted that "we are concerned by reports today that suggest many aspects of the plan may in fact not be as voluntary as originally promised. Moreover, as the nation's only communications service that is free, local and ubiquitous, we would oppose any attempt to impose onerous new spectrum fees on broadcasters."[20] The television broadcasters already recently returned 108 megahertz of spectrum as part of the transition to digital television.

C. Pole Attachments and Rights-of-Way

The Commission also proposes to take regulatory action with respect to the means by which broadband providers deploy their infrastructure. Under the Communications Act, the Commission currently regulates the rates charged to telecommunication providers for renting access to utility poles.[21] The Commission likewise proposes to regulate the rates charged to broadband providers for accessing utility poles in order to lower the costs of access.[22] The Commission also proposes to encourage the use of space-saving devices to increase the number and variety of service providers that can attach to a single pole.

The National Broadband Plan also contemplates a "joint task force" composed of the Commission and state, local, and tribal governments to craft guidelines for rates, terms and conditions for access to public rights-of-way.[23] The Commission believes that a nationally-coordinated policy will be more effective than the current system of local policies, which often differ with respect to determining access to and payment for public rights-of-way. The Commission asserts that a coordinated, national policy would reduce the inefficiencies in creating enhanced regional and national broadband networks.

D. Universal Availability and Adoption of Broadband

The Commission estimates that the cost to provide broadband access and ongoing service to those Americans not currently subscribing to broadband is $33 billion (in present value), of which only $9 billion could be recouped through new operating revenues.[24] Many of these potential users reside in rural areas, where the per capita cost of building new network infrastructure exceeds the likely per capita revenue.

The Commission therefore proposes to create a "Connect America Fund" to subsidize the cost of broadband deployment and service to rural Americans.[25] The Connect America Fund would provide subsidy payments to one commercial broadband provider in each un-served or under-served area.

The Commission also proposes to "shift" up to $15.5 billion (in present value) in other revenue sources to support subsidies for broadband access.[26] Much of this revenue would come from the reallocation of high-cost universal service subsidies. As much as $3.9 billion would come from the removal of support previously provided to Sprint and Verizon Wireless for providing service to high-cost areas.

The Commission also welcomed direct appropriations from Congress: "To accelerate broadband deployment, Congress should consider providing optional public funding to the Connect America Fund, such as a few billion dollars per

year over a two to three year period."[27] Likewise, the National Broadband Plan recommends the expansion of direct grant and loan programs, like those grants made available in the Recovery Act.

The National Broadband Plan further recommends allowing states and local governments to directly build, own, and operate broadband networks. The Commission analogizes to the early electrical grids built by municipal utilities and co-operatives, particularly in rural areas. "In some areas, local officials have decided that publicly-owned communications services are the best way to meet their residents' needs."[28]

With respect to consumers, the Commission identifies particular populations who are less likely to adopt broadband, including the elderly and low-income households. The Commission points to several factors for non-use: cost of service, digital illiteracy, and relevance.[29] Despite acknowledging that some older and lower-income Americans are not convinced of the value of broadband access, the Commission points repeatedly to cost as being the primary obstacle: "[I]f broadband costs fall because of lower prices or subsidies, consumers might be more willing to try it, in spite of doubts about its relevance or their own abilities to use it."[30] Consequently, the Commission is considering a requirement through which certain spectrum licensees would have to provide "free or very low-cost" broadband access to all households.[31]

E. National Purposes

The National Broadband Plan addresses the use of broadband services in enhancing health care, education, and energy efficiency. For each of these areas, the Commission sets forth actions to be taken by federal agencies to provide greater incentives for the use of broadband services.

With respect to health care, the Commission recommends that the Department of Health and Human Services and the Centers for Medicare and Medicaid Services ("CMS") permit and incentivize the use of health information technology.[32] This would include, for example, storing and sharing medical records electronically. Greater access to medical records would lead to more informed diagnoses and treatments, and, consequently, better medical results. Electronic medical record sharing would also reduce redundant medical tests.

The Commission also recommends encouraging the use of telemedicine and e-care. These programs enable rural doctors to share records with urban hospitals, and likewise permit doctors on urban medical campuses to assist in the treatment of rural patients remotely.[33] The Commission supports the creation of a "Health Care Broadband Access Fund" to subsidize the cost of broadband access by health care providers, particularly in rural areas.

With respect to education, the National Broadband Plan recommends the promotion of online learning.[34] In particular, the Commission recommends that the Department of Education create more educational material to be supplied to students online, and that Congress take legislative action to encourage copyright holders to permit free educational use of otherwise-protected material. The Commission also recommends that school districts provide more online courses and teach digital literacy courses.

As with health care, the Commission also recommends the implementation of digital educational records.[35] The Commission proposes that the Department of Education set a national standard for digital records, such that records may be shared freely across the country. In addition, the agency proposes to digitize financial records of school districts and states in order to improve public transparency and accountability.

With respect to energy efficiency, the National Broadband Plan focuses on facilitating a Smart Grid, the "two-way flow of electricity and information to create an automated, widely distributed energy delivery network."[36] The goal is to create a national electricity grid that detects outages, reroutes power more efficiently, and is more resilient to terrorist attack or damage. The Commission also recommends the implementation of a wide range of "smart devices," that are driven from Internet-based data. For example, the Commission cites GPS devices available to drivers that provide real-time traffic data and allow drivers to avoid traffic congestion.

III. Classification of Broadband Providers

Some of the proposals set forth in the National Broadband Plan, particularly in connection with competition policies and consumer protection, would require direct regulation of broadband providers by the Commission. As described above, while the Commission has broad authority to impose such regulations upon common carriers under Title II of the Communications Act, the Commission previously determined, and the Supreme Court affirmed, that broadband providers and other information service providers are not common carriers subject to the jurisdiction of Title II.[37]

Until recently, some had thought that the Commission could rely upon its "ancillary authority" under Title I of the Communications Act to regulate interstate and foreign communications in order to regulate broadband providers. However, the U.S. Court of Appeals for the D.C. Circuit recently held that the Commission lacked such authority necessary to impose network management regulations on broadband providers.[38] Chairman Genachowski has asserted that this opinion "cast serious doubt on the particular legal theory the Commission used for the past few years to justify its backstop role with respect to broadband Internet communications."[39]

Consequently, Chairman Genachowski has proposed to reclassify the telecommunications transmission component of broadband services as a telecommunications service subject to the Commission's Title II jurisdiction.[40] According to the Chairman, this proposal would provide the statutory basis for imposing a wide range of regulations, including those necessary to implement the National Broadband Plan. However, recognizing that this reclassification would subject broadband providers to "extensive regulations ill-suited to broadband," Chairman Genachowski also proposed to "[a]pply only a handful of provisions of Title II" by forbearing the application of other provisions of Title II that he believes are "unnecessary and inappropriate for broadband access service."[41] In sum,

the Commission would choose which provisions of Title II the agency thought necessary to implement the National Broadband Plan and appropriate to apply to broadband providers.

Endnotes

1 American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, § 6001(k)(2)(D) (2009).

2 Press Release, The White House, Statement from the President on the National Broadband Plan (Mar. 16, 2010).

3 National Broadband Plan, F.C.C. Doc. No. 09-51, at xi (Mar. 16, 2010) (the "National Broadband Plan").

4 *Id.* at 20.

5 *Id.* at xi.

6 *Id.*

7 47 U.S.C. § 201, *et seq*.

8 Nat'l Cable & Telecomms. Ass'n v. Brand X Internet Servs., 545 U.S. 967 (2005); Appropriate Framework for Broadband Access to the Internet over Wireline Facilities, Report and Order and Notice of Proposed Rulemaking, 20 F.C.C. Rcd. 14853 (2005); In the Matter of United Power Line Council's Petition for Declaratory Ruling Regarding the Classification of Broadband over Power Line Internet Access Service as an Information Service, WC Docket No. 06-10, Memorandum Opinion and Order, 21 F.C.C. Rcd. 13281 (2006); Appropriate Regulatory Treatment for Broadband Access to the Internet Over Wireless Networks, WT Docket No. 07-53, Declaratory Ruling, 22 F.C.C. Rcd. 5901 (2007).

9 *See infra* Part III.

10 National Broadband Plan, at 37.

11 *Id.* at xi-xii.

12 *Id.* at xii.

13 *Id.* at 43.

14 *Id.* at 84.

15 *Id.* at 79.

16 *Id.* at 75.

17 *Id.* at 89-92.

18 *Id.* at 92-93.

19 Press Release, Nat'l Ass'n of Broadcasters, NAB Statement on the FCC's National Broadband Plan (Mar. 15, 2010).

20 *Id.*

21 47 U.S.C. § 224.

22 National Broadband Plan, at 110.

23 *Id.* at 113.

24 *Id.* at 136-137.

25 *Id.* at 145.

26 *Id.* at 147.

27 *Id.* at 151.

28 *Id.* at 153.

29 *Id.* at 168.

30 *Id.* at 170.

31 *Id.* at 173.

32 *Id.* at 200.

33 *Id.* at 215.

34 *Id.* at 226.

35 *Id.* at 234.

36 *Id.* at 249.

37 *See supra* Part II.A and notes 6-7.

38 Comcast Corp. v. FCC, No. 08-1291 (D.C. Cir. Apr. 6, 2010).

39 Statement of Chairman Julius Genachowski (May 6, 2010), *available at* http://www.broadband.gov/the-third-way-narrowly-tailored-broadband-framework-chairman-julius-genachowski.html.

40 *Id.*

41 *Id.*

Book Reviews

Voting Rights—and Wrongs: The Elusive Quest for Racially Fair Elections

By Abigail Thernstrom

*Reviewed by Roger Clegg**

No one has written more or better about the Voting Rights Act than Abigail Thernstrom. Her latest book, *Voting Rights—and Wrongs: The Elusive Quest for Racially Fair Elections*, would, in a just world, be the last word on the subject, but alas the problems raised by the Act will continue, and so, Sisyphean, must Dr. Thernstrom's efforts.

The book is a treasure trove of historical information, and it is extraordinarily thorough in its analysis. It provides a sweeping historical narrative, and then a trenchant explanation and examination of the two key sections (2 and 5) of the Act and the jurisprudence relating to them; it ends with Congress reauthorizing the Act in 2006. So excellent and evenhanded is Dr. Thernstrom's scholarship that an admiring foreword to the book is provided by Juan Williams—who is far from being a doctrinaire conservative.

The Text of the Constitution Versus the Voting Rights Act

Section 1 of the Fifteenth Amendment provides: "The right of citizens of the United States to vote shall not be denied or abridged by the United States or by any State on account of race, color, or previous condition of servitude." Section 2 provides: "The Congress shall have power to enforce this article by appropriate legislation."[1]

The right to vote regardless of race was, to put it mildly, not honored for a long time, and the Voting Rights Act of 1965 changed that. But the principal statutes that Congress has passed pursuant to the Fifteenth Amendment—the text and evolution of which are helpfully set out by Dr. Thernstrom in one of her book's appendices—go far beyond enforcing this guarantee. Dr. Thernstrom explains that in many respects the statutes are in fact used to encourage racial segregation of voting districts through racial gerrymandering—a result at odds with the underlying constitutional guarantee, to say nothing of the ideals of the Civil Rights Movement from which the statutes sprang.

This has come about, says Dr. Thernstrom, because Section 2 (which applies nationwide) and Section 5 (which applies only to certain jurisdictions, mostly in the South, and requires them to get any changes in voting practices or procedures "precleared" in Washington) of the Voting Rights Act adopt a "results" and "effects" test, respectively. That is, they ban practices and procedures that have disproportionate results and effects, even if that practice or procedure is racially nondiscriminatory on its face, is applied equally and nondiscriminatorily, and was not adopted with any discriminatory intent. But, in this case, in what sense do we have racial discrimination? Some (like me) argue that this is *not* racial discrimination, and so such laws are not fairly within Congress's enforcement authority under the Fifteenth Amendment.[2]

The Effects/Results Test

Critics of the effects/results test contend that whenever the government uses this approach, two bad outcomes are encouraged that would not be encouraged, or would at least be encouraged less, if the government stuck to banning actual disparate treatment on the basis of race. First, actions that are perfectly legitimate will be abandoned; second, if the action is valuable enough, then surreptitious (or not so surreptitious) racial quotas will be adopted so that the action is no longer racially disparate in its impact.[3]

Thus, for example, some innocuous voting practices (for example, making sure that voters can identify themselves as U.S. citizens who are registered to vote) can be challenged if they have a racially disparate impact. And jurisdictions can be pressed to use racial gerrymandering to ensure racially-proportionate election results through racially-segregated districting, requiring discrimination, which is at odds with the underlying law's ideals.

This latter point is at the heart of Dr. Thernstrom's book: *The key use of Sections 2 and 5 in 2010 is now to coerce state and local jurisdictions into drawing districts with an eye on race, to ensure that there are African-American (and, in some instances, Latino) majorities who will elect representatives of the right color.*

Chief Justice Roberts wrote in a recent Voting Rights Act case involving racial gerrymandering that it is "a sordid business, this divvying us up by race."[4] The Supreme Court has warned about the unconstitutionality of racial gerrymandering in a number of decisions. Critics of the practice maintain that it encourages racial balkanization and identity politics. In addition, they point out that the segregated districts that gerrymandering creates have contributed to a lack of competitiveness in elections, districts that are more polarized (both racially and ideologically), the insulation of Republican candidates and incumbents from minority voters and issues of particular interest to minority communities (to the detriment of both Republicans and minorities), and, conversely, the insulation of minority candidates and incumbents from white voters (making it harder for those politicians to run eventually for statewide or other larger-jurisdiction positions).

If it is agreed that the purpose and result of Sections 2 and 5 is to encourage the use of racial classifications by government entities, the Supreme Court's Fifth Amendment jurisprudence would subject these sections to strict scrutiny. Justice Scalia noted the constitutional problems with the disparate-impact approach in his recent concurrence in *Ricci v. DeStefano*.[5]

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* *Abigail Thernstrom's* Voting Rights—and Wrongs: The Elusive Quest for Racially Fair Elections *is published by AEI Press.*

There is good news in Dr. Thernstrom's book: The problem of systematic exclusion of racial minorities from the polls no longer exists. This is not to say that there are not still instances of such discrimination, but they are aberrant. The problem that the Framers of the Fifteenth Amendment undoubtedly had foremost in their minds—and that, unconscionably, had festered until 1965—has been decisively and successfully addressed.

But Dr. Thernstrom delivers the bad news, too: There is no longer any rhyme or reason to the jurisdictions that are covered by Section 5. Given the intrusiveness of the statute, this problem is not simply an aesthetic one: It raises serious federalism concerns. What's more, because Sections 2 and 5 incorporate the "results" and "effects" test, state laws that many would consider proper are discouraged or struck down (anti-voter-fraud measures that might have a disparate impact, for example), and state practices that many would consider improper are now required (racial segregation of voting districts through racial gerrymandering, for example).

The Kinston Case

When the Supreme Court heard a constitutional challenge to Section 5 of the Voting Rights Act last year—in *Northwest Austin Municipal Utility District Number One v. Holder* (*NAMUDNO*),[6] decided after Dr. Thernstrom's book was published—the Justices did not decide the constitutional issue, instead ruling for the district on statutory grounds. But a new lawsuit filed on April 7 this year by the Center for Individual Rights, arising out of a Justice Department decision in the small town of Kinston, North Carolina, is likely to bring the constitutional issue back to the Supreme Court.

As Dr. Thernstrom explains, Section 5 was passed in 1965 as an emergency, "temporary" measure that was supposed to expire in five years. But Congress has kept renewing it, most recently in 2006, when it was extended until 2031. Section 5 essentially puts covered states in "federal receivership," she says: They cannot implement *any* changes, no matter how small, in their voting-related procedures until they are approved by the Department of Justice or a federal court in Washington.

Section 5 was an unprecedented and extraordinary incursion into the traditional sovereignty of local governments, but Dr. Thernstrom's book makes clear that something like it was needed in 1965. Chief Justice Roberts wrote in *NAMUDNO* that discrimination was "rampant" in the South, where local officials engaged in systematic, widespread actions to prevent black Americans from registering and voting. Although this was illegal, many jurisdictions would simply pass new laws or switch to new discriminatory procedures if they lost a lawsuit. Section 5's preapproval process was intended to prevent that widespread evasion of the law and court-ordered remedies.

Of course, we are a much different nation today, and Dr. Thernstrom masterfully marshals the data that demonstrate why. No one claims that discrimination has completely disappeared, but there is no longer systematic, intentional discrimination by state and local governments in large parts of the country. "Things have changed in the South," the Court said in *NAMUDNO*. "Blatantly discriminatory evasions of federal [court] decrees are rare. And minority candidates hold office at unprecedented levels."

Local governments in Virginia and Arizona, for example, which are covered by Section 5, are currently no different from local governments in, say, Arkansas and New Mexico, which are not covered, and thus some legitimately question why they should be singled out and why the federal government is still given the extraordinary power to veto legislative changes in those states. And so, last year, the Supreme Court warned that Section 5 now raises serious constitutional concerns. These concerns are heightened when one considers the fact that states like Georgia and Mississippi are covered based on evidence and election data that are more than forty years old. By the time Section 5 is up for renewal in 2031, counties like those in North Carolina will have been covered based on seventy-year-old election returns.

The Kinston Specifics

Finally, Dr. Thernstrom argues that, over the years, the Justice Department's Civil Rights Division has engaged in extremely partisan, ideological administration of Section 5. For opponents, Kinston, North Carolina provides an example of the irrationality of the continued application of Section 5 and the ideological partisanship in the Division's administration of it. Blacks make up sixty-four percent of the registered voters in Kinston, and there has been no finding that the town has engaged in any discriminatory voting practices. There are no barriers to blacks registering and voting in Kinston. In 2008, Kinston residents voted two to one to change their town elections from partisan to nonpartisan; there were only eight out of 551 localities in North Carolina that held partisan local elections. A majority of the voters in five of the seven majority-black precincts in Kinston voted in favor of the change.

The Obama Administration's Justice Department objected to the reform, claiming that the black citizens of Kinston did not have the right to make this change and declaring that it would reduce the ability of black candidates to be elected since they would no longer be affiliated with the Democratic Party. Thus, critics have claimed that the Justice Department was using federal law to promote the interests of the Democratic Party rather than black voters.

Using federal law to set aside the decision made by voters to change to nonpartisan elections, based on the assumptions of federal bureaucrats about future elections, demonstrates the problems of administering Section 5. So does its application to a jurisdiction in which black voters are not a minority, but are in fact a majority that can completely control election outcomes. Other Voting Rights Act partisanship problems have also been on display in the controversy caused by the Obama Administration's decision not to prosecute members of the New Black Panther Party for intimidating voters at a Philadelphia polling place.

Conclusion

Many hope that, when the Kinston case reaches the Supreme Court, the Justices will acknowledge that we are a different country today than we were in 1965, and that the extraordinary displacement of traditional local sovereignty represented by Section 5 is not only no longer needed, but

violates the most fundamental federalism and colorblind principles of the Constitution.

When the Supreme Court does decide its next Voting Rights Act case, here's hoping that the Justices, or at least a majority of them, or at least someone writing a brief in the case, will have read Abigail Thernstrom's wonderful book.

Endnotes

1 Useful histories of the passage of the Fifteenth Amendment can be found in Alexander Keyssar, The Right to Vote 93-104 (2000), and The Heritage Guide to the Constitution 409-11 (Edwin Meese III et al. eds., 2005). Neither suggests, however, that the amendment means or was intended to mean anything more or less than what its text actually says.

2 For an argument that Section 203 of the Voting Rights Act, which requires some jurisdictions to print ballots and other election materials in foreign languages, is likewise objectionable and unconstitutional, see Roger Clegg & Linda Chavez, *An Analysis of the Reauthorized Sections 5 and 203 of the Voting Rights Act of 1965: Bad Policy and Unconstitutional*, 5 Geo. J.L. & Pub. Pol'y 561, 575-80 (2007).

3 My criticisms of the disparate-impact approach in civil-rights enforcement generally are set out in Disparate Impact in the Private Sector: A Theory Going Haywire (National Legal Center for the Public Interest 2001), *available at* http://www.aei.org/paper/100116, which elaborates on *The Bad Law of "Disparate Impact,"* Pub. Int. 79 (Winter 2009), *available at* http://www.nationalaffairs.com/public_interest/detail/the-bad-law-of-disparate-impact.

Let me add that, even under a disparate impact/effects/results approach, the defendant can prevail if it can show a sufficiently strong reason for the challenged practice. Thus, for example, I've argued that the disenfranchisement of felons ought to be lawful under Section 2 of the Voting Rights Act, even if Section 2 applies and even if it has racially disproportionate results. *See, e.g.,* Roger Clegg et al., *The Case Against Felon Voting*, 2 U. St. Thomas J.L. & Pub. Pol'y 1, 12 (2008). But the pressure to abandon criteria with racially disproportionate results, or to overlay them with quotas, remains.

4 League of United Latin American Citizens v. Perry, 548 U.S. 399, 511 (2006) (Roberts, C.J., concurring in part and dissenting in part). Among the Supreme Court's anti-racial-gerrymandering pronouncements, see especially *Shaw v. Reno*, 509 U.S. 630 (1993), and *Miller v. Johnson*, 515 U.S. 300 (1995). Regarding the bad side-effects of racial gerrymandering, see generally Roger Clegg & Linda Chavez, *supra* note 2 (citing, inter alia, Christopher M. Burke, The Appearance of Equality: Racial Gerrymandering, Redistricting, and the Supreme Court 32-33 (1999); and Katharine Inglis Butler, *Racial Fairness and Traditional Districting Standards: Observations on the Impact of the Voting Rights Act on Geographic Representation*, 57 S.C. L. Rev. 749, 780-81 (2006)). *See also* Jim Sleeper, Liberal Racism 43-66 (1997); Sheryll D. Cashin, *Democracy, Race, and Multiculturalism in the Twenty-First Century: Will the Voting Rights Act Ever Be Obsolete?*, 22 Wash. U. J.L. & Pol'y 71, 90 (2006).

5 129 S. Ct. 2658 (2009).

6 129 S. Ct. 2504 (2009).

We're Not Dead Yet.[1]
Book Review: The Vanishing American Lawyer

By Thomas D. Morgan

*Reviewed by Allison R. Hayward**

Is the practice of law a profession? For most practicing lawyers, the last time they heard that question was from the podium of their ABA-mandated Professional Responsibility class. But this is but one of many fundamental questions asked by Thomas Morgan, Oppenheim Professor of Antitrust and Trade Regulations at the George Washington University Law School and leading light of legal ethics scholarship. In *The Vanishing American Lawyer*, Morgan takes a fresh and markedly heterodox posture on questions regarding professionalism, practice, and legal education.

The hallmarks of a profession include the mastery of knowledge beyond a client's ability to grasp, a duty to serve public as well as private interests, and discipline by one's peers. But as Morgan observes, changes in the practice of law have transformed many lawyers into scriveners, whose conduct is best regulated under principal-agent standards. Pause for a moment—what's professional about lawyering a real estate closing? Morgan criticizes the establishment Bar for clinging to "professionalism" and failing to face reality.

Reality is this: most lawyers perform tasks to fulfill narrow specific client demands, without regard to whatever other interests there may be. Lawyers are thus more akin to business consultants than to professionals. Lawyers for the most part do not function above the fray and do not exercise independent judgment about the merits of a client's goals. In fact, given the disaggregation and specialization of modern private law practice, it would be hard to imagine it otherwise. Today's successful lawyer is not the generalist of yesterday, but an expert who has mastered an especially thorny area of practice. That specialist can tell you everything about the taxation of international pharmaceuticals, or the ins and outs of reinsurance contracts. But it will be the in-house counsel—an employee—who oversees the company's legal portfolio.

While the reality of law practice today demands specialization and mastery of the arcane, legal education hasn't responded. Morgan calls for experimentation and variety in legal education. But Morgan also notes that with the ABA standing at each law school's door, enforcing blanket standards, few law schools would care to innovate. Similarly, the outsized influence of the U.S. News rankings discourages any dean from trying something novel, for fear of a hit in the rankings.

Morgan argues that law schools need to do a better job of training specialists. This means crafting a curriculum that focuses on skills and offers substantive experience in a field. But Morgan does not endorse the recommendations of what he

* *Assistant Professor of Law, George Mason University School of Law (2006-10); Vice President of Policy for the Center for Competitive Politics.*

calls "the always hovering Carnegie Foundation." Carnegie has endorsed law school clinical programs as an essential element in a model curriculum. But clinics are a very inefficient and expensive means for delivering skills training, and as Morgan notes, clinics may themselves be based on outdated notions of what lawyers really do. Even better? Working in the field. Morgan's insight would seem to suggest reworking legal education along the lines of business education, where the student comes to the degree program having already worked in the field of specialization. Barring that, law schools might place greater emphasis on externships, or joint degree programs that graduate a student who is prepared to give useful advice for specific client needs.

Today, attorneys acquire specializations by serving as apprentices. Junior associates in law firms learn a specialty at the direction of partners and senior associates. But this model is failing. Clients (or their in-house counsel) resent paying professional fees for someone's apprentice. Consequently, the partner will write off the apprentice's time. But a firm can't make money that way—unless the junior associate works very, very hard to compensate. Hence the birth of the 2400, 2600, even 3000 hour billable year. Anybody who stops to do the math can appreciate how ridiculous these requirements are. As Morgan observes, a reasonable work schedule, which allowed for a vacation, weekends, and time for networking and professional development, would yield about 1300 billable hours. Associates either work themselves to death, cheat, or escape. Oddly, one of Morgan's suggestions is to strengthen rules that restrict young lawyer mobility. I believe that only makes sense if corresponding changes to legal education happen.

The establishment Bar has been quiet about the ethical implications of this system. Certainly the Model Rules and their state counterparts require attorneys to perform with competence and diligence. For 3000 hours? Unlikely. Here, too, the legal "profession" has yielded autonomy to clients and to their malpractice insurers. Lawyers now are less subject to outmoded ethical standards enforced by their peers, but more subject to performance standards set by the firm's malpractice insurers and threats of litigation from unhappy clients. Again, this reinforces the client-centric character of modern legal practice, and the role of the lawyer as "agent" rather than "professional."

Morgan predicts that the future will still have a place for the trial lawyer, so Clarence Darrow is safe for now. The future will also have a place for the lawyer-specialist. Law firms will still make sense as a means for aggregating specialists who can offer a range of services. Morgan doesn't mention whether relaxing imputed conflicts restrictions would be a good or useful development, but that may be the trend. Morgan does argue for relaxing the fee-splitting rules, so attorneys can practice with non-attorney experts. Clerks should do routine and high volume work, and to the extent rules restricting the unauthorized practice of law impede their use, the bar should evolve and accommodate.

Morgan's American lawyer is not so much "vanishing" but "transforming." (A better title for the book might have been "The Transformation of American Lawyers," except Oxford already publishes Morton Horwitz's *The Transformation of American Law*.) What is vanishing is the professional characteristics that law practice once had. Not all those characteristics were admirable. Many state bars restricted competition, set minimum prices, and forbade advertising all in the name of peer-enforcement of "ethics."

The most troubling aspects Morgan identifies are within legal education. Many students entering law school lack experience or focus. Law school has become the default graduate education for students who don't know what they want to do with themselves. Thus they are unparticular customers and grasp at national ratings to tell them where they should attend. Their law school's curriculum will likely be indistinct, divided between "skills" training often taught by adjuncts and term faculty, lecture classes that may be offering substantive material or "think like a lawyer" interrogation, depending on the professor's priorities, and for a few, expensive inefficient clinics.

After three years of this education, students still spend thousands more on bar review instruction to pass an exam and earn the right to practice law. Once (hopefully) employed, students begin to acquire specific expertise. Legal education doesn't seem to have much to do with training lawyers. One wonders whether the present situation is sustainable.

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Thomas D. Morgan's The Vanishing American Lawyer *is published by Oxford University Press.*

Endnotes

1 Monty Python and the Holy Grail (1975).

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