E n g a g e

Volume 4, Issue 1 May 2003

Letter from the Editor...

E n g a g e, the journal of the Federalist Society for Law and Public Policy Studies, is a collaborative effort involving each of the Society's fifteen Practice Groups. The Federalist Society's Practice Groups spark a level of debate and discussion on important topics that is all too often lacking in today's legal community. Through their programs, conferences and publications, the Practice Groups contribute to the marketplace of ideas in a way that is collegial, measured, and open to all.

Volume 4, Issue 1, following the trend of our recent issues, is dedicated almost exclusively to original articles produced by Society members and friends. Judicial confirmation hearings and the Securities and Exchange Commission's rulemaking under Sarbanes-Oxley are just two of the hot topics that have inspired written work in this issue. Activity in the courts is also well documented, with *Sprietsma v. Mercury Marine*, *Nike v. Kasky*, *Central Bank of Denver v. First Interstate Bank of Denver,* and the Quick Service Restaurants cases representing only a sampling of those commented on in the pages that follow.

Also notable in this issue are several reviews of fantastic books. C. Boyden Gray contributed a review of Judge David Sentelle's recent book *Judge Dave and the Rainbow People*, and Professor Nelson Lund gives his analysis of *Bush v. Gore: The Question of Legitimacy* by Bruce Ackerman.

Upcoming issues of Engage will feature other original articles, essays, book reviews, practice updates and transcripts of programs that are of interest to Federalist Society members. We hope you find this and future issues thought-provoking and informative.

E n g a g e

Volume 4, Issue 1 May 2003

The Journal of the Federalist Society's Practice Groups

Engage

Volume 4, Issue 1 May 2003

The Journal of the Federalist Society's Practice Groups

Administrative Law & Regulation

The Presidential Appointment Process at the Beginning of the 21st Century

*By Alec D. Rogers**

Introduction

The quality of appointments to the executive branch has long been identified as a vital aspect of an administration's success. Of the many things about which he could worry at the beginning of his Presidency, for instance, the one that most worried Thomas Jefferson was who would serve in the executive branch of government: "There is nothing I am so anxious about as good nominations," he wrote as he was preparing to assume office. Yet, over the past several years, there has been growing consensus that the process by which the President appoints and the Senate confirms high level executive branch appointees has become so long and arduous that many potential appointees may decide that it is better to stay at one's law firm or investment bank than to uproot the family, sell the house, divest the portfolio and move to Washington, only to have to wait for months on end to be confirmed to a position that pays one-half of their private sector salaries.

Last November, the Presidential Appointment Initiative of the Brookings Institution (PAI) took out a full-page advertisement in several newspapers decrying the current state of the appointment process. The advertisement was signed by a large number of former appointees of both parties, and included luminaries such as former Senate Majority Leader Howard Baker, former Reagan Secretary of State George Shultz, former Clinton Secretary of State Warren Christopher, former Reagan White House Counsel Arthur Culvahouse Jr., and former Carter and Clinton White House Counsel Lloyd Cutler. It urged various procedural reforms to ease the burdens the process places on nominees.

The Importance of Personnel and the Costs of an Unwieldy Process

The importance of personnel selection is not in controversy, although some experts place an especially high premium on it over other aspects of governance. The Heritage Foundation, which has produced extensive amounts of management advice as well as policy analyses for the executive branch, sums up the importance of personnel: "Personnel is policy."[1]

The problem is particularly acute in the American system of government where the civil service is overseen by a level of politically appointed "amateur" administrators who serve at the pleasure of the President and only in very rare cases will outlast him. More likely, several appointees will serve in any given slot during the President's tenure in office. As columnist E.J. Dionne notes, "no country is as dependent on 'citizen service' in its national administration." Accordingly, the civil service in the U.S. is diminished in a way unlike other industrial nations: "day-to-day civil servants who make the American government run do not enjoy the honor and prestige of their counterparts in France or Germany, Britain and Japan," Dionne notes.

One of the most obvious costs of a process that delays the filling of appointments is that many posts, even key posts, can go vacant for long periods of time. A study conducted by the Century Foundation, for instance, found that in the spring of 1997 the U.S. lacked an ambassador to 15 important countries, including Canada (which had been without an ambassador for almost a year), Germany (10 months), Russia (five months), Japan (three months) and France (two months). At the same time, one-third of the most senior 750 positions in the administration were unfilled. Agencies particularly affected included the Federal Elections Commission, which was unable to muster a quorum for much of 1998, the Food and Drug Administration, which lacked a commissioner for a year and a half, and the Surgeon General's post, which went unfilled for years. The result is a bureaucracy run not by the President's accountable appointees, but mostly by unelected civil servants whose accountability is significantly weaker due to civil service protections.

An administration will frequently counter such a state of affairs by increasing use of a variety of tricks, such as making recess appointments, temporary appointments, and "acting" appointments to circumvent the Senate's confirmation process and the delays it can entail. As a result, the Senate is also ultimately weakened by the break down of the appointments process. President Clinton's use of these techniques reached the point where Congress passed a new law limiting their use in 1998. The law clarified the status of these types of appointees and the limits on the President's power in this regard, although it also ensured him a lot of flexibility as well. Congressional oversight is also impaired by a lack of politically accountable personnel in key executive positions. Administrations are reluctant to allow civil servants to testify at hearings and interact directly with congressional oversight efforts. By their nature, civil servants are cautious, and tend to err on the side of disclosing too little rather than too much. Without a political appointee in place to interact with Congress, it is more difficult for the legislative and executive branch to interact on a particular topic.

Management of executive branch personnel, administered by the second and third tier appointees (deputies, assistants and deputy assistants) is especially vital, according to Heritage, because it influences the President's overall ability to steer the government. Although management prowess is highly valued, most important is the appointee's "commitment to [the President's] policy agenda and their ability to advance, articulate and defend it." By doing so, it ensures that the actual decision-making will be done by the political appointees rather than the career civil servants, whose "credibility as neutral administrators of politically directed policies would be permanently compromised," according to Heritage. Other commentators generally concur in the importance of having the President's team in place in a prompt manner, and the dangers of having long standing vacancies in key roles.

If the President's ability to govern the executive branch of government is weakened because the Senate does not promptly consider and confirm nominees, his accountability to the American people is diminished. Rather than accepting the blame for poorly executed policy, the President can shift blame to the Senate for failing to promptly confirm his nominee. Colby College political science professor Calvin McKenzie likens the current confirmation process to a dysfunctional corporation in this regard:

> Imagine this: after a lengthy search, you are aggressively recruited to lead a large corporation. The hiring committee tells you that it has chosen you because it admires your vision of what the company can become. It wants you to do whatever is necessary to increase the company's profit and ensure its future strength. This is a job you've been seeking, so you are anxious to start and begin thinking of the kinds of people you'll need to recruit to head up the company's important divisions.
>
> But then the hiring committee says, "Oh, by the way, did we mention that all of your top personnel choices will have to be approved by a committee that includes some of your worst enemies, any one of whom can blackball any of your selections?"
>
> Who would be willing to run a company under these conditions? Who would be willing to be held accountable for its performance?[2]

Next, a dysfunctional process reduces the quality of the appointees by reducing the talent pool. A recent article on the search for a new Securities and Exchange Commission Chairman, for instance, mentioned that two of the most prominent candidates had asked that their names be removed because they did not wish to undergo the confirmation process. Fewer candidates willing to undergo the confirmation process results in a smaller pool of appointees, and, in some cases, will mean that the most highly qualified person will not serve.

A Widespread Perception of Breakdown

The charge that the appointment and confirmation process has "broken down" and is in need of reform has become widespread in the views of many from both parties and other observers. There has been no shortage of study of the problem, particularly in the past two decades as the process has gotten more and more onerous and slow.[3]

The Presidential Appointment Initiative was founded at the Brookings Institute to provide a forum for study and discussion of the appointments process, and its deleterious impact on government service. Its goals are to provide a "pragmatic" and "non-partisan" reform agenda; offer assistance to nominees to help them through the process; and "rekindle an appreciation for public service" that the PAI claims has been dampened by the public's reluctance to serve given the workings of the appointment process. PAI has also produced reports on other aspects of government service that impacts its desirability, such as overrigorous ethics rules and low pay.

The Transition to Governing Project also examined many of these issues. In a three-year period, the project, which was based at the American Enterprise Institute and conducted jointly with the Hoover Institution, the Brookings Institution, and other think tanks, produced two major conferences and several publications. It was concerned more broadly with the problem of moving from campaign to governing mode for new administrations, but identified the appointment and confirmation process as significant impediments to getting a new administration up and running quickly.

In addition, the New Century Foundation conducted a study in 1996 entitled "Obstacle Course," followed up by a 1997 study that noted that "during 1997 the vacancy rate for top posts in the administration frequently exceeded 25%, reaching 30% at the end of August" and that "unless some positive action is taken to improve the presidential appointment processes, Americans will lose in two ways: the government will not be able to function efficiently and we will not be able to attract the best qualified people to these positions."

Flaws in the Current System

Although there is general agreement that the appointment process is functioning poorly, there is less agreement about the causes and, consequently, the solutions.

First, once a nominee is selected, he or she is immediately buried in paperwork, including many overlapping, duplicative questionnaires. Old records must be retrieved and significant amounts of very private records such as tax returns must be produced.

Next, a lengthy background check is conducted to ensure that the nominee has not engaged in illegal or unethical conduct that would provoke opposition and/or embarrass the administration that nominated him.

Some have identified problems in the Senate procedures that can delay a nomination once it reaches the Senate. The Senate's prerogatives and procedures are well known, and many view them as a positive in the legislative context. In contrast with the energetic House, which proposes many legislative initiatives, the Senate's pace is notoriously slow, and provides for "cooling." The same traditions, procedures and prerogatives in the context of the appointment process, however, have been the basis for criticism by some.

The first is the filibuster, by which any Senator can effectively block a vote on any nominee unless 60 members support cloture. The very threat of a filibuster is often enough to delay consideration of a nomination. In addition, filibusters are sometimes used to support a Senator's policy goals unrelated to the merits of the particular nominee. The next is the tradition of senatorial courtesy, which requires that a nomination have the assent of both of the nominee's home state Senators. Assent is signaled by the return of a blue slip of paper from both Senators, without which the nomination will not move forward. Finally, a committee chairman can, by virtue of their control over their committee's schedule, delay a nomination indefinitely be refusing to hold hearings or schedule a vote to report the nomination to the Senate for its consideration.

Proposed Solutions

Given the differing views of what is causing the current problems with the appointment process, it is no surprise that there is a divergence of views on the proper remedies, which range from streamlining paperwork to proposals that arguably would require a constitutional amendment.

Reforming Senate Rules

One set of reforms focuses on the Senate's rules and procedures. Barring the use of the filibuster and "holds"[4] when dealing with nominations is one suggestion. Another would require that the Senate provide every nominee with an up or down vote within a certain period of time. Both would, however, not only require a change to the written rules of the Senate, but its unwritten (and arguably more important) norm of unlimited debate.

Constitutional Structure

One proposal would actually seriously reorder the current process by reviving the use of the legislative veto by turning the constitution's requirement that the Senate consent to a nomination into a requirement that it veto the appointment, stipulating that certain presidential appointments be deemed consented to unless the Senate affirmatively defeated it within a certain amount of time. Such a structure would likely be objected to by the Senate's minority, which currently can obstruct a nomination but cannot force a vote to be called. In addition, such a proposal raises obvious questions under the Supreme Court's decision in *Chadha v. INS*, although it does not deal with legislation.

Streamlining the Preliminaries

Some suggestions focus on the process that occurs prior to a nomination being voted on, namely the investigation. First, some critics question the need to a "full field" FBI investigation on less significant nominations. Next, suggestions have been made that the FBI and other investigative agencies be temporarily augmented at times when nominations are expected to be particularly high, such as the start of a new administration and, perhaps, after midterm elections.

Streamline the Disclosure Process

Another way of reducing earlier delays in the process, it is suggested, could be accomplished by streamlining the many and varied disclosure forms that applicants are required to fill out prior to their appointments.

Fewer Presidential Appointments

Reducing the number of Presidential appointments would, correspondingly, reduce the impact that the deteriorating appointments process has on the operations of the federal government. For instance, in most other countries, ambassadors are chosen from the foreign service rather than made by political appointment. Promoting civil servants to more significant policy-making roles would arguably promote greater competence and experience, and reduce the tensions between the bureaucracy and its top leadership, now drawn from its ranks.

Such a development could create more problems than it would solve. It would significantly reduce the President's ability to run the executive branch and place what are, essentially, political decisions in the hands of unelected officials whose removal would be difficult, or perhaps impossible, under current civil service laws.

Fewer Confirmations

Some advocate reducing the number of appointees subject to Senate confirmation. Senate confirmation adds perhaps the bulk of the time to the delay in implementing an appointment. Saving Senate confirmations for more significant posts would speed up many appointments and reduce the opportunity for Senators to hold up non-controversial nominations over unrelated disputes. For that very reason, however, it would be unlikely that the Senate would consent to a significant reduction in the number of Presidential appointees subject to Senate confirmation.

Fewer Hearings

Saving hearings for more policy sensitive posts rather than requiring every single nominee whose nomination is subject to Senate confirmation is a possible compromise between those who advocate reducing the number of appointees subject to Senate confirmation, and those who fear doing so would reduce the Senate's influence too much. Currently, hearings are the norm, even for many uncontroversial nominations. Rather than scheduling time for one Senator to gavel an empty committee room "to order," listen to a panel of nominees for some government board each read their five minute openings and respond with scripted answers to scripted questions, hearings could be reserved only for posts with the most significant implications or those nominations that were controversial for other reasons. If these situations became the norm for hearings, attendance at them might be greater if Senators realized that scheduling a hearing was no longer a matter of routine, but marked a confirmation hearing of significance. As a result, non-controversial nominees would face one less hurdle, while more controversial ones received greater scrutiny.

Conclusions

Reforming the Presidential appointments process is an inherently political task. It will involve value judgments about the right blend of loyalty and competence, and which value will weigh more or less heavily.

*Alec D. Rogers is a Republican Senate staffer. Any views expressed are solely his own.

Footnotes

[1] See, *inter alia*, Robert Moffitt, "Personnel is Policy: Why the New President Must Take Control of the Executive Branch," Heritage Foundation Backgrounder No. 1403, January 8, 2001.

[2] Calvin McKenzie, "Nasty and Brutish Without Being Short: The State of the Presidential Appointment Process," Brookings Review, Spring 2001, Vol. 19, No. 2, pp 4-7.

[3] For example, over the past 40 years the time to fill presidentially appointed positions has grown from 2.4 to 8.5 months. Only one out of 20 appointees took more than six months to confirm between 1964 and 1984. From 1984 through 1999, one in three took more than six months.

[4] "A senator's request that his or her party leaders delay floor consideration of a certain measure or presidential nomination. The majority leader usually honors a hold for a reasonable period of time, especially if its purpose is to assure the senator that the matter will not be called up during his or her absence or to give the senator time to gather necessary information." *American Congressional Dictionary,* Congressional Quarterly.

The Secret History of the Administrative State

*By Thomas W. Merrill**

For the last couple years, I have been digging into some history that sheds new light on the creation of the American administrative state. The research grew out of work on the Supreme Court's *Chevron* doctrine, which requires courts to defer to reasonable agency interpretations of statutes.[1] In two recent decisions, *Christensen* and *Mead*,[2] the Court cut back on *Chevron*, saying that it applies only to agency interpretations that have the "force of law." In order for agency interpretations have the force of law, the Court explained, Congress must delegate authority to the agency to act with the force of law.

The next logical question would seem to be: How do we know when Congress has delegated power to an agency to act with the force of law? The Court has not provided an answer to this question, at least not a very clear one. And in the context of rulemaking, which is responsible for most of today's important agency interpretations, we run almost immediately into a problem: statutes almost never say in so many words whether the agency has power to make rules with the force of law, or legislative rules. Instead, they typically say that the agency has authority to make "rules and regulations" necessary to carry out or implement the statute – without specifying whether those rules can be legislative rules, or are limited to interpretative and procedural rules. So starting a couple years ago, I set out, together with a co-author, Kathryn Watts, who was then a third year student at Northwestern, to try to discover what Congress understood when it created these ubiquitous rulemaking grants that are ambiguous on their face as to whether they authorize legislative rulemaking.

The results are set forth in a 120 page article in a recent issue of the Harvard Law Review.[3] What follows is a very brief recap of the principal findings of that paper, some musing about the broader implications of those findings in terms of the history of the administrative state, and some tentative thoughts about where we should go from here.

First, what we found. Throughout the twentieth century, Congress has delegated rulemaking power to agencies in ambiguous language. We found only one statute still on the books that explicitly says an agency is authorized to make rules with "the force and effect of law."[4] But it turns out that from about World War I up though at least the end of the New Deal, Congress followed a drafting convention for signaling whether any particular rulemaking grant was intended to confer power to make rules with the force of law. That convention was simple and easy to apply in most cases: If Congress coupled the rulemaking grant with another statutory provision imposing some sanction on persons who violate the agency's rules – meaning criminal penalities, civil fines, loss of benefits, or other legal consequences – then the grant was understood to confer legislative rulemaking power. But if Congress just enacted a naked rulemaking grant, without any provision for sanctions for rule violators, then the grant was understood to confer only interpretative and procedural rulemaking powers. Under this convention, a number of important agencies, including the Securities Exchange Commission, the Social Security Administration, and the Federal Communications Commission (at least as to broadcasting) had been given general rulemaking grants that conferred legislative rulemaking power. But other important agencies, including the Federal Trade Commission, the National Labor Relations Board, the Food and Drug Administration, and the Treasury Department (as to the Internal Revenue Code) had general rulemaking grants that did *not* confer legislative rulemaking power.

When I learned about this convention, I was quite surprised. Although I have taught administrative law for a number of years, I had never heard of it before. When Kathryn and I went back and looked at all the Supreme Court decisions that involved rulemaking grants in the last century, it quickly became clear why. The drafting convention employed by Congress to signal whether legislative rulemaking power was being given to an agency is never mentioned in any of these decisions. The Supreme Court has long recognized the distinction between legislative rules and interpretative rules. And it has long recognized that agencies can make legislative rules only if authorized to do so by Congress. But never in its glorious history did the Court articulate any understanding about how one determines when Congress has conferred the required power on an agency. The issue just slid by in silence.

The final chapter of the story has to do with what happened in the 1960s and 1970s. This was the era when many commentators and judges suddenly discovered the virtues of rulemaking. Rules were thought to be more fair than adjudication because they announced legal duties in advance. Rules were also regarded as a more powerful weapon, permitting agencies to protect workers, consumers, and the environment more effectively than could be done through case-by-case adjudication. It was in this context that prominent court of appeals judges took advantage of the facial ambiguity of rulemaking grants to transfer enhanced rulemaking authority to agencies. In *National Petroleum Refiners v. FTC*,[5] decided in 1973, Judge J. Skelly Wright held for the DC Circuit that the ambiguous rulemaking grant in the Federal Trade Commission Act of 1914 authorized legislative rules, even though this was inconsistent with 60 years of understanding to the contrary. This was followed by decisions of the Second Circuit in 1975 and 1981,[6] the most prominent of which was authored by Judge Henry Friendly, holding that the general rulemaking grant in the Federal Food Drug and Cosmetic Act of 1938 authorized legislative rulemaking – this determination being inconsistent with only about 40 years of unbroken understanding to the contrary.

The Wright and Friendly opinions inaugurated the

modern understanding – which is nearly always assumed rather than articulated explicitly – that all rulemaking grants authorize legislative rules, unless Congress has explicitly limited the agency to interpretative or procedural rulemaking. For example, the NRLB is universally assumed to have legislative rulemaking authority (although it almost never uses it), even though this is contrary to the intent of Congress as indicated by the New Deal-era drafting convention. And agencies like the Department of Housing and Urban Development and the Environmental Protection Agency are often assumed to have authority to issue legislative rules under general rulemaking grants that doubtfully confer such authority.

Let me shift gears at this point and offer some reflections on the implications of these findings in terms of the growth of the administrative state. Broadly speaking, one can say that the modern administrative state rests on three critical constitutional propositions – three legs of the stool if you will. Each of these understandings provides a necessary prop supporting modern regulatory enterprises of vast power such as the Environmental Protection Agency, the Food and Drug Administration, or the Securities and Exchange Commission.

The first leg, which is quite familiar, is the understanding that the enumerated powers of Congress are sufficiently broad to permit the federal government to regulate virtually any aspect of social and economic activity. The main vehicle here of course has been the Commerce Clause, which has been interpreted to permit the regulation of any activity of a commercial nature having a substantial affect on interstate commerce. One can quarrel with this conclusion, and the Supreme Court has begun in recent years to do some trimming and rationalizing around the edges. But at the very least no one can maintain that there is anything secret about this understanding. Congress itself has at times wrestled publicly with the question of how to construe its enumerated powers; academics and other commentators have written extensively on the subject; and, perhaps most prominently, the Supreme Court has rendered dozens of decisions on the subject.

The second leg is the understanding that Congress can delegate authority to administrative agencies to make discretionary policy choices with relatively little guidance from Congress. This is the famous and again highly familiar nondelegation doctrine issue. Article I section one of the Constitution says "All legislative Powers herein granted shall be vested in a Congress of the United States." It has been argued that this means that only Congress can make significant discretionary policy choices, and that these choices cannot be turned over to an agency to make. The Court, however, has almost never enforced this understanding, and has repeatedly held that, as long as Congress has laid down an "intelligible principle" to guide the agency, Congress can delegate significant discretionary powers.[7] Again, whatever one thinks about the correctness of this position, at least the issue has been repeatedly and publicly debated – in Congress, in the halls of the academy, and before the Supreme Court.

The third leg is the understanding that Congress can delegate authority to administrative agencies to make rules with the force of law. The language of the first section of Article I would also seem to be relevant here. If it is plausible that this language means that Congress cannot transfer power to make discretionary choices to agencies, then it is equally or more plausible that it means Congress cannot transfer authority to agencies to make mini-statutes. This is where the historical research described above becomes relevant. Notice that this third leg supporting the modern administrative state, in contrast to the first two, can hardly be said to be one that has received a thorough and vigorous public debate in any forum.

Let's start with Congress. In the nineteenth century, Congress occasionally enacted statutes stating explicitly that certain agencies were being given authority to make rules "with the force and effect of law."[8] But starting around World War I, this practice largely stopped, and was replaced by the convention I have described, in which Congress signaled that it was giving legislative rulemaking authority by enacting an ambiguous rulemaking grant and then also enacting some type of sanction for those who violate rules. Why did Congress prefer the oblique and indirect convention to simply stating upfront that it was delegating power to make rules with the force of law? We cannot know for sure. But one plausible explanation is that it was controversial to delegate authority to agencies to enact what amount to statutes, given the language of Article I suggesting Congress was supposed to do this itself. In order to mute the controversy, Congress adopted a signaling mechanism that obscured the issue, and rendered it more likely that the transfer of lawmaking authority would pass unnoticed by opponents of the legislation.

What about academics? Here the performance can only be described as dismal in the extreme. I have no doubt that influential administrative law scholars who came out of the New Deal and taught administrative law in the post-World War II era were aware of potential constitutional objections to delegating power to agencies to make legislative rules. But, to a man (they were all men), they omitted any discussion of the issue in their writings and teaching materials. For example, Walter Gellhorn was the research director of the Attorney General's Committee on Administrative Procedure that undertook a massive study of administrative law in the late 1930s. The materials produced by the committee contain several references to the drafting convention used by Congress to signal the delegation of legislative rulemaking authority. But when Gellhorn wrote a monograph on administrative law in the early 1940s, and later authored the most widely-used casebook on the subject in the 1950s, the issue was ignored. Similarly, Kenneth Culp Davis, another New Deal veteran, was probably the leading expert on rulemaking coming out of the New Deal. He also became, in the 1960s, the leading academic proponent of expanded use of rulemaking by agencies. Yet throughout his voluminous writings, there is no allusion to the constitutional question about whether Congress can delegate the power to make legislative

rules, nor is there even any discussion about how one might tell whether Congress has or has not delegated such power. Why did the academics bury the issue? Again I can only speculate, but it is plausible that being ardent New Dealers and supporters of the administrative state, they recognized that the question was awkward and potentially destabilizing to the enterprise they identified with, and so they decided it was best not to stir up trouble.

We come then to the courts. The Supreme Court wins no prizes for its performance in this area. The cases in which the Court has episodically puzzled over the meaning of rulemaking grants reflect no comprehension of the delegation issue or how it might be resolved. But I do not really blame the Court for this. The cases arose at very irregular intervals, and an examination of the briefs reveals that none of the parties ever alerted the Court to the larger constitutional question or to the convention Congress had used for signaling the delegation of legislative powers.

The decisions of the lower courts, especially the Wright and Friendly decisions conferring general legislative rulemaking authority on the FTC and the FDA, are another matter. These are shameful – the worst kind of activist decision in which the court knows there is a right answer to the legal question before it, but ignores it in favor of another answer that it thinks is preferable. What is more, by inaugurating the understanding that any ambiguous rulemaking grant confers power on the agency to make rules with the force of law, the Wright and Friendly decisions may have achieved the largest one-time transfer of power from one branch of government to another in the history of our Republic. And they did so without any acknowledgement that this was happening.

So where do we go from here? Kathryn and I discuss a number of possibilities at the end of the article, including using the original drafting convention of the New Deal era as a canon of interpretation in construing ambiguous rulemaking grants. Yet I think the history and its implications for the growth of the administrative state raises a broader issue.

The Supreme Court has long maintained that the Vesting Clause of Article I means that Congress and Congress only has the power to legislate. The legislative power may not be delegated. The Court has recognized that this reading is in tension with statutes that give agencies broad discretion to make policy, and it has sought to reconcile this tension with the "intelligible principle" doctrine. In the meantime, however, Congress has repeatedly delegated power to agencies to make legislative rules. But the Court has not even commented on how this can be reconciled with the understanding that only Congress has the power to legislate, and the administrative law fraternity has brushed the issue under the rug. It seems to me that no reconciliation is possible. If Article I, section one means that only Congress can legislate, then it is unconstitutional to delegate power to agencies to make legislative rules.

But perhaps the Court has been wrong all along in its assumption that the Vesting Clause of Article I prohibits delegation of legislative power. Consider the language again: "All legislative Powers *herein granted* shall be vested in a Congress of the United States." This simply says that the only legislative powers granted by *the Constitution itself* go to Congress. In other words, neither the Executive Branch nor the Judicial Branch have any inherent power to make law; there is no executive or judicial prerogative. So read, the Vesting Clause does not say anything one way or the other about whether Congress can delegate its legislative powers to some other entity. As Eric Posner and Adrian Vermeule have recently written, all complex organizations delegate, and there is no good reason to think that the Framers of the Constitution intended to deny this necessary power to the federal government. [9]

So read, the Vesting Clause would not incorporate a nondelegation doctrine, but rather a delegation doctrine. It would say, not that the power to legislate may never be delegated to an agency, but rather that an agency can exercise the power to legislate only if it has been delegated authority to do so by Congress. The best way to implement this understanding would be through an express statement rule, requiring that Congress state explicitly when it is delegating the power to make rules with the force of law to an agency. But I am afraid it would be too disruptive to adopt such an understanding at this late date. At the very least, however, courts should require evidence of a clear congressional intent to delegate power to act with the force of law. Mere ambiguity – the usual "rules and regulations" formulation – should not be enough.

I do not propose this reading out of hostility to the administrative state. The administrative state can be a force for good, as long as it is properly directed and checked and balanced. I am motivated rather by a desire for coherence and candor. If we are to reconcile the administrative state with our Constitution's structure, we need an open public discussion about how agencies can engage in legislative rulemaking. For the last 100 years we have debated other propositions that must be established to have a federal administrative state. But this issue has been suppressed. Let the discussion begin.

* Thomas W. Merrill is the John Paul Stevens Professor, Northwestern University School of Law; Visiting Scholar, University of Chicago Law School.

Footnotes

[1] *Chevron U.S.A. Inc. v. Natural Resources Def. Council,* Inc., 467 U.S. 837 (1984).

[2] *Christensen v. Harris County,* 529 U.S. 576 (2000); United States v. Mead Corp., 533 U.S. 218 (2001).

[3] Thomas W. Merrill and Kathryn Tongue Watts, Agency Rules with the Force of Law: The Original Convention, 116 Harv. L. Rev. 467 (2002).

[4] Agricultural Adjustment Act of 1933, 7 U.S.C. § 610(c) (2000).

[5] 482 F.2d 672 (D.C. Cir. 1973).

[6] *National Nutritional Foods Ass'n v. Weinberger,* 512 F.2d 688 (2d Cir. 1975); *National Ass'n of Pharmaceutical Manufacturers v. FDA,* 637 F.2d 877 (2d Cir. 1981) (Friendly, J.).

[7] See, most recently, *Whitman v. Am. Trucking Ass'ns,* 531 U.S. 457 (2001).

[8] Merrill and Watts, supra note 3 at 497.

[9] See Eric A. Posner & Adrian Vermeule, Interring the Nondelegation Doctrine, 69 U.Chi. L. Rev. 1721 (2002).

Panel Analyzes First Amendment Concerns Raised in Pharmaceutical Regulation

Summary of "FDA and the First Amendment"--October 21, 2002

Recent court decisions reflect increasing judicial interest in the constitutional protections afforded to speech regarding the safe and effective use of pharmaceutical drugs. In the late 1990s, two U.S. district courts ruled that the U.S. Food and Drug Administration's (FDA) regulations governing the provision of journal articles to doctors describing the off-label uses of drugs overstepped its bounds.[1] In 2002, the U.S. Supreme Court held that FDA restrictions on pharmacists' advertising of compounding services violated the First Amendment.[2]

In response to this increasing judicial scrutiny of its regulation of commercial speech in the pharmaceutical market, the Food and Drug Administration issued a notice in the Federal Register last May soliciting comments about how it could best fulfill its mission consistent with First Amendment protections. "Recent years have witnessed increased attention by consumers to their own medical care. The public's interest in, and access to, useful and truthful information about medical products have skyrocketed," noted the FDA's release. The FDA asked several questions, such as: are there better arguments for regulating speech regarding drugs than there are for dietary supplements? How prominent do disclaimers need to be? How far can FDA go in regulating speech concerning so-called "off-label uses" (*i.e.,* those for which the FDA has not given approval)? Finally, the FDA asked whether any of its regulations or practices generally were thought to run afoul of the First Amendment. In all, the FDA sought input in nine different areas of free speech and regulation.

The Federalist Society's Administrative Law and Free Speech practice groups presented a joint panel on the Food and Drug Administration and the first amendment at the National Press Club to discuss the issues raised by this solicitation. Panelists included Richard Cooper, former Chief Counsel to the FDA; Arnold Friede of pharmaceutical manufacturer Pfizer; Richard Samp of the Washington Legal Foundation (WLF); William Schultz, a former FDA Associate Commissioner for Policy; Bruce Silverglade of the Center for Science in the Public Interest (CSPI); and William Waller, the Chair of the Federalist Society's Food and Drug subcommittee. Erik Jaffe, Chair of the Society's Free Speech subcommittee, introduced the panel.

Jaffe established the framework by outlining the current state of commercial free speech. Constitutional protection of commercial speech, as currently understood, has four elements, said Jaffe. First, it could neither be false nor misleading, nor relate to unlawful activity. Second, the government needed a "substantial interest" if it was to regulate commercial speech. Third, such regulations had to directly advance that substantial interest. Finally, such regulation could not go further than the substantial interest.

The WLF's Samp begun by expressing gratitude that the FDA was concerned about free speech issues, noting that, prior to 1976, the concept of commercial free speech really did not exist in constitutional law. Most recently, Samp noted, the Supreme Court's decision in *Thompson v. Western States* had finally applied the commercial speech doctrine explicitly to the FDA, and further clarified that FDA restrictions on speech were not justified regardless of the rationale should other means of accomplishing it be available. As a result, the Court rejected the government's argument that the best way to regulate compounding was by restricting advertising rather than direct regulation.

Samp turned to the various interests that the FDA could use to justify restrictions on commercial speech. The first is to prevent misleading speech. The next interest is to establish and enforce the approval process for drugs. Should manufacturers not be required to prove their claims to the FDA, there would not be the same standard of approval for drugs as currently exists, he noted. Finally, Samp cited the interest the government has in preventing the over-prescription of drugs, especially as it bears an increasing burden of drug costs in the U.S.

The FDA, argues Samp, runs into difficulties when defending these interests. First, it is difficult to determine whether speech *is* misleading in the first place. Recent decisions, says Samp, demonstrate that courts will not allow the FDA to be the arbiter of whether commercial speech is misleading. The fact that FDA has not verified a claim's truthfulness cannot, Samp argues, be enough for it to prohibit the speech. The interest in promoting regulatory compliance is a valid one, acknowledged Samp. But, it will often be difficult for the government to show that the substantial interest at hand will be directly promoted by the regulation. Finally, Samp predicted that the government's interest in preventing over-prescription will be rejected by courts as "paternalism."

Former FDA Assistant Commissioner Schultz recalled the incident with DES, a drug once promoted by doctors at the Harvard Medical School as a wonder drug for preventing miscarriages. It was so successful, they believed at the time, that *all* pregnant women should have it administered – not just those at risk of miscarriages. In fact, the drug had no beneficial effects and horrible side effects, including cancer and reproductive complications in the daughters of those women who had taken DES. Congress's reaction included the 1962 Kefauver amendments to the Food Drug and Cosmetic Act, which required that drug companies prove "substantial evidence" of a drug's efficacy prior to its being allowed on the market.

Such regulation finally provided drug companies a substantial incentive to conduct research on the drugs doctors were giving patients, said Schultz.

Schultz then addressed arguments being advanced to weaken regulation of off-label uses. When he was at the FDA, he related, he was sympathetic to the idea that distributing research on drugs to doctors should be allowed so that they could determine for themselves whether such secondary use was wise. A discussion with a former drug representative, however, changed his mind. She related to him how handing out such things as journal articles actually suppressed in-depth research because doctors tended to take them on faith without substantial, further inquiry.

Turning to the question of advertising, Shultz noted arguments that there should be a lower standard for advertising than labeling. In other words, rather than meeting the "substantial evidence" test, some argued, drug companies should be allowed to make advertising claims until government regulators proved them false. Such a rule, however, would vitiate the labeling requirements because what patients and even doctors knew about drugs was more likely to be derived from advertising than labels, contended Shultz.

Finally, Shultz argued that, in fact, courts had not been as sympathetic to First Amendment arguments as some had claimed. Although one district court case had, Shultz acknowledged, held that there was a right to distribute journal articles regarding unapproved uses, that decision had been vacated by the Court of Appeals. Next, the Court in *Pearson* had explicitly stated that its rationale should *not* be applied to drugs, its rationale being limited to dietary supplements.

Pfizer's Friede responded that the FDA *had* amassed a poor track record in recent cases. The FDA's request for comments on the legality of various uses of its power was more appropriately seen as a way to avoid what Friede characterized as the fate of the Federal Communications Commission in terms of losing credibility with the courts, rather than as an attempt to undermine its mission as some congressional critics had alleged.

Friede summarized Pfizer's response to the FDA's call for comments. First, Pfizer stressed the useful benefits that consumer information has on informed decision making. Critics have, Friede noted, have alleged that too much information could actually have negative effects on consumer health. Friede drew upon First Amendment cases in other contexts to suggest that the courts could evaluate FDA regulations on the claims of drug makers under a more benign standard, while still extending First Amendment protections. The FDA should be commended for thinking about the First Amendment implications of its regulations, regardless of their views on Pfizer's own position, Friede concluded.

Regulation, not the First Amendment, has had more efficacy in providing consumers with useful information CSPI's Bruce Silverglade begun. He cited the example of the Nutrition Labeling Education Act, which requires that food labels provide nutritional information. The same law gave dietary supplement makers the right to make claims about their products' benefits. Silverglade was concerned that the public might not be able to tell the difference between FDA *approve*d health claims and FDA *authorized* claims. Silverglade noted that such over-reaching claims by supplement manufacturers have actually led to a decrease in sales, as the ability to make unsubstantiated claims has led consumers to doubt the efficacy of even those supplements whose claims were proven. He wondered why attorneys for the drug industry would try to gain the same "freedoms" via First Amendment litigation.

The FDA's solicitation of comments on the applicability of the First Amendment was actually an attempt to hide a deregulatory agenda behind the First Amendment, continued Silverglade. He noted that former FDA Chairman David Kessler, who had once been a Republican Senate staffer, had voiced similar views.

Silverglade said that the campaign to expand the commercial speech doctrine in general would "turn free speech into a license for quackery." Companies should be careful to ensure that First Amendment jurisprudence creates what Silverglade called "a level of First Amendment protection that creates a level, competitive playing field." The alternative, according to Silverglade, would be "a marketplace free-for-all."

As a final point, Silverglade mentioned a recent National Academy of Sciences report that concluded that claims about nutrient-disease relationships were "more easily made than scientifically supported." As an example, he cited beta-carotene, which was supposed to have a positive effect on lung cancer, according to an article in the *New England Journal of Medicine*. Subsequent further research, including research published in the New England Journal, ultimately revealed that beta-carotene actually increased risks of lung cancer, according to Silverglade.

Former FDA Counsel Cooper posed a "thought test" to the panel's audience. The test's purpose, Cooper said, was to test the audience's commitment to two emerging principles in commercial free speech law. The first was that truthful speech couldn't be suppressed on the grounds that it will lead to bad decisions. The second was that the answer for bad decision-making was more speech rather than less.

Suppose, Cooper posited, we had a regime under which the FDA would create "official labeling" for every approved drug. Inside each package would be inserted its government-approved instructions on when to prescribe the drug and how much to prescribe. This language would be inserted into the Physician's Desk Reference. Cooper analyzed such official instructions as "government speech." The pharmaceutical company would have no ownership of it.

The pharmaceutical company would be allowed, Cooper continued, to make its own claims in advertise-

ments, medical journals, detailing pieces left with practitioners, or in booths at professional meetings, etc. This speech could offer different views on uses, dosage, or anything else about the drug. Such speech would not need to be based on adequate and well-controlled studies. It would simply need to qualify as "truthful and non-misleading," as defined by the FDA. Further, the company would need to disclose when such claims were not established under the adequate and well-controlled studies standard.

This would give doctors the option of being either conservative (by restricting their dispensation to the government's approved instructions) or to take greater risks when they thought appropriate (by relying on broader claims issued by the maker). This would test the value of the FDA's imprimatur, and the extent it was worth the company's attempts to get FDA approval rather than relying on the company's reputation for competence and integrity.

Cooper addressed some concerns he had about the FDA's power to test the drug company's claims. He proposed that it could send an inspector to the company to investigate the claim. If it were not satisfied, it could denounce the company's claims, sue it for misbranding, or even pull the product off the shelf, depending on its view of the seriousness the company's claims posed to the public's health. Cooper asked the audience to evaluate such a regime by asking whether the scenario was plausible and realistic? Was it constitutionally required? Finally, even if it were not, was it a good idea anyway, Cooper inquired.

During the question and answer period, Silverglade addressed the latter question, observing that such a regime would amount to "regulation through press release," which he deemed "a horrible way to regulate." Such an approach was after the fact, which meant, "people have already been injured. People have died already." Press releases only affect the information mix for so long, he noted. "If you didn't read the paper that day, you can miss the message and you can die the next day."

After Cooper's presentation, the panel hosted questions from the audience. One participant opened by asking Silverglade whether he thought the FDA's renewed sensitivity to free speech had yet resulted in the marketing of unsafe dietary supplements. Silverglade said that it had, but the news really had not gotten out yet. The newspapers began to carry stories about the hazards of dietary supplements only months after courts started to get involved in considering such arguments. Cooper noted that it was interesting that the FDA had shown concern about First Amendment issues, despite never having lost an enforcement action due to a First Amendment defense.

Another participant raised the issue of why speech, rather than use, was regulated. If something is not authorized for a particular purpose, why not just outlaw its use for that purpose rather than outlawing speech advocating that it be used for that purpose? Pfizer's Friede answered that Pfizer had not pushed that approach in its comments, but it *had* taken the view that unapproved uses ought to be freely discussed without hindrance. "We understand that the statute prohibits promotion for off-label uses. We endorse that. But that's a far cry from saying any dissemination whatsoever automatically becomes an overt promotion." Such speech, he theorized, should be treated as "scientific speech" rather than "commercial speech."

Cooper added that it would be impracticable to ban off-label uses for drugs. "There are many…off-label uses that are critical to health care and that are the standard of care for treating certain conditions," he observed. While current law prohibited manufacturers from speaking about off-label uses of their own drugs, Cooper added, such speech by others *was* allowed. Samp added that exceptions were allowed where information was solicited from the manufacturer, which only adds further to the confusion.

The virtues of the Internet for health information research were the subject of one question. Friede noted the Internet provided a "wealth of information." The problem was that, while some sites were "very, very good," others were "very, very poor." The widespread publication and availability of health related information on the Internet revealed that at least one of the government's assumptions was invalid, Friede noted, namely that it could control the information pool by regulating one small channel of information.

The full text of the voluminous comments filed in response to the FDA's request can be read on-line at: http://www.fda.gov/ohrms/dockets/dockets/02n0209/02n0209.doc.

Footnotes

[1] See *Washington Legal Foundation v. Friedman*, 13 F. Supp.2d 51 (1998) and *Washington Legal Foundation v. Henney*, 56 F. Supp.2d 81 (1999).

[2] *Thompson v. Western States Medical Center*, 122 S. Ct. 1497 (2002).

Civil Rights

A Dialogue on Reparations

*By Roger Clegg**

Between an Opponent and a Supporter:

A: Should African Americans be paid reparations for slavery?

B: The short answer is no, but first let's unpack that question. Do you mean only for slavery, because most reparations advocates also think that reparations are appropriate for post-slavery discrimination.

A. Oh, yes. That should be included, too.

B. But in that case, why limit it to blacks? Other groups have been discriminated against as well.

A. But not as much, wouldn't you agree?

B. I suppose, although you could make a case that the treatment of American Indians has been pretty bad. And Japanese Americans were the only ones actually interned.

A. That's true; those are the two others that are especially bad. But the existence of treaties and reservations makes it possible to consider American Indians separately, and of course the Japanese Americans who were interned already have received reparations.

B Fair enough. You would concede that other groups have been discriminated against, too, obviously, but your point is that they didn't suffer under an actual Jim Crow system?

A. Correct.

B. But Latino advocates would argue that there has been school and housing segregation, ethnic gerrymandering, and employment discrimination against them. So might Asian advocates. I actually agree with you that it is easy enough to draw a line between blacks and everyone else. But I want to make the point that if you open the door to reparations for blacks for non-slavery discrimination, then others will try to come through that door.

A. Well, what if we limit it to reparations just for slavery, then?

B. This will complicate matters considerably. For instance, it then becomes important that only those with slave ancestors be compensated. Blacks who immigrated after the 13th Amendment (December 6, 1865) cannot really claim to have been victims of slavery, nor can their descendants, nor can the descendants of black freemen.

A. But aren't the vast majority of African Americans descendants of slaves?

B. Good question. I don't know. You would agree that the higher the percentage who aren't, the more problematic reparations for all African Americans is, right?

A. Yes, but you would agree that if the percentage is high enough, the assumption that all blacks qualify is a reasonable one?

B. Reasonable, yes, although perhaps not so compelling and narrowly tailored—as the lawyers put it—to pass strict scrutiny. Let me also ask you this. How will we prove who is an African American? That is, if someone claims his or her share of reparations, how will you determine if they are in fact an African American.

A. Won't just looking at the person be good enough in most cases?

B. It depends on how honest you think people are. If you start handing out $50,000 checks for anyone who claims to be an African American, and you take everyone at his word, I predict you will have some problems with false claims. To put it mildly.

A. Let's have a two-part test. If you can tell the person is black just by looking at them, that's good enough. If not, then the person has to provide some additional proof.

B. And the ones who aren't judged to be black, even though they assert they are, will then have to prove it in some way. DNA tests? Genealogical records? Sworn affidavits?

A. Something like that.

B. As I pointed out earlier, that will be more difficult if you have to show that you are a slave's descendant. And, do you get your check even if you have only one African American ancestor?

A. I don't see any alternative. A person and his or her ancestors probably will have suffered a fair amount of discrimination even with one ancestor.

B. All right. I agree that it would be very broad if you had to trace back not just to one ancestor but to several. By the way, how are you going to define African American?

A. Someone whose ancestors came from Africa.

B. But it can't be just anywhere in Africa, right? White South Africans won't do, nor would North African Arabs, right? Back to my line example, suppose someone admits that he doesn't "look black," but says that's just because his African ancestors were Afrikaner or Egyptian or Moroccan. And what if he can prove it?

A. Well, I can see that it would be a problem if we had to prove immigration from a specific country. Maybe the DNA or genealogical records could help.

B. Maybe. But there's a certain irony here, since generally those supporting reparations also believe that race is a social construct without any true basis in biological science.

A. Look, I see your point, but many reparations advocates make clear that they aren't proposing that individual checks be cut. Instead, they want social programs put in place as the reparations. So you aren't going to have this problem of whites claiming to be blacks.

B. Granted, there will be less fraud if what you're offering in a place in a special school or job training facility rather than a $50,000 check.

A. A lot less.

B. All right. Of course, it's a fair question why a poor or working class white—whose ancestors probably suffered some, too, one way or another—shouldn't be eligible for the programs anyhow. But that brings us to the basic question: Should society pay reparations to all blacks, and only to blacks?

A. The discrimination suffered by African Americans was especially cruel, and so special compensation is required.

B. But, that doesn't make sense. The special cruelty isn't present now, and wasn't suffered by most blacks living now. The median age of African Americans is about 30, which means a birth-date after the end of the Jim Crow era. So it can't be the special cruelty. It must be that the economic impact was especially severe and long-lasting.

A. Economic impact is certainly part of the long-term effects.

B. But if it's the economic impact that matters, why does it matter what its origins were? You have one orphan whose parents were lynched, and another child whose parents were drowned when their boat sank in the South China Sea. Both are penniless, homeless, and alone. Why do we make some programs available to one but not to the other?

A. America didn't sink the boat. But it did the lynching. Remember it is *reparations* we are talking about. Reparations are paid by the wrongdoer to the victim. America is responsible for slavery and Jim Crow discrimination in a way it is not responsible for other calamities that some people have suffered. We *owe* something to blacks, in a way we don't to anyone else.

B. What do you mean "we"? The American people now—its taxpayers, voters, officials, and so forth—are in no way responsible for slavery or Jim Crow discrimination. Even if you say that it was the fault of American federal and state governments and corporations and other non-human entities that were around then and are around now, the reparations are going to have to come out of the pockets of those who *don't* owe African Americans for exploitation, because they weren't around when the exploitation happened.

A. But they still enjoy the profits from that exploitation.

B. Let's talk about that. If you mean that America as a whole was built on the backs of slave labor—an exaggeration, but I'll concede that certainly slave labor was one kind of labor that helped build America—it is true that we still enjoy the results of slave labor, but then that is no less true for blacks than for whites. That is, slaves may have cleared the farmland that now feeds us, but it feeds us black and white alike.

A. But whites profited more from it than blacks did.

B. Certainly slaveowners profited from it more than slaves did. But you're assuming that the class of 19th century slaveowners and slaves is the same as the class of 21st century whites (really, nonblacks) and blacks. The groups are completely different. It's also very hard for the government tries to ascertain how much wealth a person would have if nothing unfair happened to any of one's ancestors. The problem with the game, of course, is that it is impossible to untangle the past. There's no doubt that slavery and discrimination have, in the aggregate, diminished the wealth of African Americans. But so have disproportionately high rates of illegitimacy, and substance abuse, and crime, and a failure to take advantage of the educational, employment, and business opportunities that were available. To be sure, these bad life-decisions were often a result of discrimination, but quantifying the causation is impossible.

Let me also point out that most of the wealth that the nonblacks have was acquired after slavery. Lots of nonblacks—not just Asians and Latinos, but the Irish and Italians, for instance—didn't arrive here until after slavery. And lots of people who did have some wealth in the early 20th century saw it wiped out in the Great Depression. So telling the descendants of these people that they have to pay out a chunk of their wealth in reparations for slavery doesn't make a lot of sense.

A. Enough! This is all logic chopping. The fact of the matter is that slavery and Jim Crow discrimination were uniquely grievous wrongs, that they did result in present blacks hav-

ing less money than they would have if they had been treated decently, and that it is only fair that they be compensated for these wrongs. Reparations will give many minorities a sense of repose, and we will close a terrible chapter in our history.

B. I think the points I've raised are more fundamental and more valid than mere logic chopping. But even if you think that, after weighing my arguments against yours, there remain some potential benefits to reparations, you also have to weigh the costs.

A. Such as?

B. Reparations could be poisonous to race relations. They could increase white resentment, and they will increase blacks' victim mentality. Those are the last things we need. As discussed, there are also serious practical problems in deciding who is eligible for the program; other groups will soon demand reparations, too; and I will guarantee you that, once the program is begun, it will never end, and the demands for more and more reparations will only increase over time, and never diminish.

* Roger Clegg is general counsel at the Center for Equal Opportunity in Sterling, Virginia. He is chairman of the Federalist Society's Civil Rights Practice Group.

Cornerstones of American Democracy:
A Primer on Judicial Restraint, Federalism, and Nominations to the Federal Bench

*By Jennifer C. Braceras**

A fully-staffed, balanced, and independent judiciary is necessary for the protection of our safety, freedom, and civil rights. Yet today the American justice system is imperiled by an extraordinary number of federal judicial vacancies and by the efforts of some to prevent the confirmation of qualified judicial nominees and thereby politicize what Alexander Hamilton once referred to as our government's "least dangerous" branch.

Of course, political battles over judicial nominees are nothing new. But unlike previous judicial confirmation fights, where special interest groups sought to defeat a particular candidate for the federal bench, the current assault is being waged not simply against a specific individual but against certain judicial philosophies.

By painting a number of current judicial nominees with a broad brush, the critics hope to avoid having to challenge a particular nominee's qualifications. The strategy is simple: convince the American public that judicial restraint and federalism imperil the rights of women and minorities and then label adherents to these philosophies as "hostile to civil rights" and unfit for federal judicial service.

This paper will examine briefly the role of the courts in American law and provide context for the current debate over federalism and judicial restraint. Defining these principles helps shed some light on the constitutional context for the current confirmation battles. And it demonstrates judicial adherence to principles of restraint and federalism is critical to the preservation of democracy, liberty, and freedom for all Americans.

I. Judicial Restraint

In announcing his first group of judicial nominees on May 9, 2001, President George W. Bush explained his criteria for selecting federal judges. He stated: "Every judge I appoint will be a person who clearly understands the role of a judge is to interpret the law, not to legislate from the bench. To paraphrase James Madison, the courts exist to exercise not the will of men, but the judgment of law. My judicial nominees will know the difference." The President, in other words, promised to nominate to the federal bench men and women who will exercise judicial restraint.

A. "Restraint" Defined

The term "judicial restraint" refers to the idea that the role of a judge is not to make policy or establish new legal rights, but to interpret the law as written in the United States Constitution or in statutes passed by the legislature. Because the will of the people is best expressed through legislative bodies, judges must strive to adhere to the law as written even if, at times, the law is insufficient to deal with certain circumstances or conflicts with the judge's personal political views.[1]

"Judicial activism," by contrast, refers to results-oriented judging, whereby a judge decides the outcome of a case based not on the law as written, but on his or her conception of what is just or fair. "Judicial activism" is often improperly confused with the power of "judicial review," which is the power of the judiciary to invalidate statutes that are in conflict with the United States Constitution. The fact that a judge frequently invalidates unconstitutional laws may make him "active" in the dictionary sense of the term, but it does not necessarily make him a "judicial activist." To the contrary, a "judicial activist" is a judge who creates new rights not expressly granted by the Constitution or by statute, or who invalidates laws, not because they conflict with express textual mandates, but because the judge views them as bad public policy.

Although the term "judicial restraint" is often associated with political conservatism, and "judicial activism" often associated with political liberalism, they are not properly categorized as such. "Judicial restraint" and "judicial activism" refer to the process or method a judge uses to reach a particular decision, not to the political ramifications of that decision. Political liberals and political conservatives are, at least theoretically, equally capable of exercising restraint on the bench. By the same token, judicial activists may use their authority to achieve either conservative or liberal results. As such, the terms "judicial restraint" and "judicial activism" are neither inherently "conservative" nor inherently "liberal."

Consider the following examples of judicial *restraint*:

- A state legislature passes a "right-to-die" law that is challenged in federal court by religious groups who argue that the statute conflicts with the fundamental right to "life, liberty, and the pursuit of happiness." The judge, who is known to be a supporter of pro-life causes, puts aside his personal opinions and upholds the law on the ground that the United States Constitution does not mention, let alone guarantee, the "right to life."
- The United States Congress passes a statute prohibiting flag-burning. An individual prosecuted for burning a flag at a political rally challenges the law, arguing that it violates his constitutional right to free speech and expression. The judge hearing the case is a political conservative and a war veteran who is greatly offended by any desecration of the flag. Nevertheless, the judge puts aside his personal convictions and strikes down the statute as contrary to the First Amendment of the United States Constitution.
- A state legislature passes a law that prohibits "discrimination against, or preferences in favor of, any individual or group on the basis of race in the operation of public employment, public education, or public contracting." Special interest groups file a lawsuit arguing that

the measure violates the Equal Protection Clause of the Fourteenth Amendment, which prohibits discrimination by state actors. Plaintiffs argue that the law discriminates against minorities by eliminating state "affirmative action" programs intended to help minorities gain an equal footing with whites. Plaintiffs argue that such racial preferences are constitutionally permissible where the state demonstrates a compelling interest for the program and that, by prohibiting the use of lawful preferences, the new statute runs afoul of the Constitution's guarantee of equal protection of the laws. The judge hearing the case is a political liberal who favors "affirmative action." Nevertheless, the judge puts aside her personal convictions and upholds the state law. The judge reasons that a law that prohibits the state from classifying individuals on the basis of race cannot possibly violate constitutional provisions banning race discrimination. Moreover, the judge explains that, while the Constitution may permit "affirmative action" in compelling circumstances, it does not require states to engage in such practices in order to comply with equal protection mandates.

In each of these cases, the judges in question interpret the law without regard to their own strongly-held convictions.

In the first case, the judge may personally disapprove of the law in question, but he recognizes that it is within the power of the state to pass any law not expressly forbidden by the United States Constitution. Since there is no constitutional "right to life," the so-called "right-to-die" statute passes constitutional muster. In this case, a judge who appears to be politically conservative exercises restraint and obtains a result that might be labeled politically liberal.

The second case illustrates how restraint can be present even when a judge acts to invalidate a democratically enacted law. Here the judge in question invalidates the flag-burning statute because it conflicts with an earlier binding ruling of the United States Supreme Court and an express provision of the United States Constitution—the First Amendment. Significantly, the judge invalidates the law despite his personal political convictions on the matter. In this case, a politically conservative judge exercises restraint and obtains a politically liberal result, but one that is consistent with precedent and the dictates of the Constitution.

Unlike the first two examples, the third case illustrates how a politically liberal judge might exercise restraint and end up with a politically conservative result. The judge personally favors racial preferences. Yet she puts her own views aside in ruling that individual states may choose to prohibit even those preferences that are permissible under the Constitution.

Now consider the following two examples of judicial *activism*:

• The United States Congress passes a law requiring that airport security personnel be paid at least $3.00 above the federal minimum wage and limiting the number of daily and weekly hours that such employees may work. A federal court invalidates the law as an interference with the "freedom of contract."

• A state legislature passes a law requiring local authorities to issue a permit to carry a concealed weapon to any law-abiding citizen who is at least 21 years of age. A lawsuit is brought challenging the statute, and a federal judge invalidates the statute on the grounds that the indiscriminate issuance of gun permits violates the "right of the citizenry to be safe."

In the first of these two cases, the judge relies improperly on the general principle of "freedom of contract"—which is nowhere expressed in the text of the Constitution—to strike down a federal labor law, thus achieving what might be called a politically conservative result.

In the next example, the judge relies on another so-called "right" not found in the Constitution—the "right to safety"—in striking down a statute that expanded the rights of gun owners. This judge thus employs judicial activism to achieve what might be called a politically liberal result. Although the political implications of these latter two cases point in opposite directions, both decisions are based on improper considerations of non-constitutional theories and thus lack legitimacy.

B. The Need For Legitimacy

Why is it important for our courts to maintain institutional legitimacy? Why should judges refrain from invalidating unsound laws and upholding sensible ones irrespective of constitutional dictates? Simply put, judicial activism is undemocratic and threatens America's system of representative selfgovernment.[2] Our government is based on a separation of powers outlined in the United States Constitution. Under this system, the legislative branch enacts the law; the executive branch enforces the law; and the judicial branch interprets the law and applies it to particular circumstances. Democratically elected legislatures, responding to the will of the people, are entitled to pass any law not expressly forbidden by the Constitution. The fact that a particular law might be bad public policy, economically unwise, or even morally offensive is no justification for judicial invalidation. As Alexander Hamilton wrote in the Federalist Papers: "It can be of no weight to say that the courts, on the pretense of a repugnancy, may substitute their own pleasure to the constitutional intentions of the legislature" (Federalist 78).

On the other hand, when a legislature passes a law which conflicts with our Constitution, or which the legislature is not constitutionally authorized to enact, the judiciary *must* invalidate the law, even if the law is a good one. Indeed, the failure to do so can also rob the courts of institutional legitimacy. As Judge Diarmuid F. O'Scannlain of the U.S. Court of Appeals for the Ninth Circuit has written, "if [a democratically enacted law] affronts the federal Constitution—the Constitution which the people of the United States themselves ordained and established— the court merely reminds the people that they must govern themselves in accordance with the principles of their own choosing."[3]

Judges who fail to anchor their decisions in Constitutional or statutory text are legally adrift, guided only by

their own personal morals and world-view. If judges refuse to abide by the elementary principle of restraint, and operate as philosopher kings, our constitutional system becomes both unpredictable and unstable. A system in which a judge can decide any case however he or she sees fit—where the outcome of the case then depends not on the law but on the judge assigned to hear the case—puts everyone's freedom at risk.

In sum, it is not the province of the judiciary to set public policy or create new legal rights. Yet this is exactly what some special interest groups would like the judiciary to do.

C. Special Interest Groups and Opposition to Nominees Committed to Judicial Restraint

Special interest groups exist for the purpose of promoting specific public policies consistent with their organization's core values and mission. They do this legitimately by trying to persuade the public and members of the legislative branch of government as to the merits of their positions on certain issues and through grass-roots campaigns in support of particular policies. Unfortunately, however, some special interest groups are not content to plead their case to the American people and to their elected representatives. Fearing that they might fail to persuade a majority of the public or elected legislators to adopt their views, these groups turn to the courts to enact their agenda by judicial fiat.

Because many special interest groups rely on the courts to mandate social policies that cannot be enacted democratically and to strike down those laws with which they disagree, many such groups oppose the nomination and confirmation of judges who do not have a public record which passes their political litmus test. Moreover, they will oppose any nominee with a record of personal opposition to any of their pet issues—even if the nominee in question is perfectly capable of setting aside her personal political views in order to apply the law as written.

Although liberal special interest groups have been most active in the fight to politicize the judiciary, some conservative groups have also inappropriately sought to politicize the federal bench by supporting only those judges who agree with their political agenda. The abortion issue illustrates the problem. Suppose, for example, that a left-wing feminist group has decided to make abortion its signature issue. As part of its goal of ensuring universal access to abortion on demand, the feminist group launches a high-profile attack against a judicial nominee who is personally pro-life and who, as a former politician, voted to restrict abortion in his state. The same group also works to defeat the nomination of a state court judge to the federal bench on the ground that, as a state judge, the nominee upheld a parental notification law that fell within constitutional parameters.

In the first of these examples, it is clear that the hypothetical feminist group's objection to the nominee is based on opposition to the concept of judicial restraint, or, at the very least, a belief that one can never put aside personal opinions when applying the law. If, however, the hypothetical nominee in fact practices judicial restraint, it should not matter whether he is personally pro-life or pro-choice, so long as he is capable of upholding a constitutionally enacted law protecting access to abortion.

The feminist group's opposition to the second nominee is grounded on support of judicial activism—that is, approval of judicial policy-making. In this example, the group opposes the judge because she upheld a parental notification law that fell within constitutional parameters. Even though the law was constitutional, the activist group believes the judge should have invalidated the law as an improper restriction on abortion on demand. In other words, the feminist special interest group will endorse only those judges who are willing to legislate from the bench a constitutional right to abortion on demand.

Suppose, further, that a conservative special interest group seeks to prohibit abortion. They are thwarted in their efforts to do so by the Supreme Court's 1973 ruling in *Roe v. Wade,* which legalized abortion in most circumstances. The group actively seeks the appointment of judges who are not only willing to overturn *Roe v. Wade*, thus returning the abortion question to the democratically elected branches of government, but who will find a constitutional "right to life," even though the United States Constitution is silent on the question of abortion. The group vows to defeat one nominee who is on record as being personally pro-choice and launches an attack against another nominee who, as a state court judge, upheld a law under which the state paid for abortions for poor women. In this example, the hypothetical conservative group has rejected judicial restraint in favor of judicial activism. Like the feminist group, the conservative group rejects the notion that a judge can put his personal opinions regarding abortion aside in ruling on a matter involving that issue. And, like the feminist group, it promotes judicial activism by supporting only those judges who will legislate a certain political position from the bench.

In these examples, both groups are supporters of judicial activism, even though they seek to use that activism for different ends. And both seek to apply (different) political litmus tests to federal judicial nominees. Although the above are just hypothetical examples, there are in fact many special interest groups which lack confidence in their ability to win at the ballot box, and are thus willing to undermine the integrity of the judicial process by supporting the nomination and confirmation of only those judges who agree with the group's political agenda and who are willing to ignore the law and use the power of the judiciary to impose that agenda on the American people.

II. Federalism

A. "Federalism" Defined

Federalism is a theory of government embodied in the United States Constitution that refers to the apportionment of power between the national government and the states.

Our Founders believed that establishing competing governmental power centers would impose discipline on gov-

ernment at both levels and thereby help to preserve individual liberty. Accordingly, the framers of our Constitution created a federal government of limited powers: Under our Constitution, the federal (or national) government may exert only those powers that are expressly enumerated; all other powers are reserved to the states. Article I, Section 8 of the Constitution provides a list of the powers of the federal government. The Tenth Amendment to the Constitution states that, "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

American federalism represents the normative determination that the powers of government should remain "few and defined" (James Madison, Federalist 45), so that no centralized authority can use its power to unduly limit American freedom. Federalism acts as a constraint on government—preventing the national bureaucracy from becoming all powerful, and preserving individual liberty by keeping government power close to the people. As Chief Justice of the United States William H. Rehnquist has explained, one of the first principles of our constitutional republic is that the national government is a government of limited power. As such, the "Constitution requires a distinction between what is truly national and what is truly local."[4] This is the essence of our federal system.

In one sense, then, federalism (like judicial restraint) is about political legitimacy. It is about demonstrating respect for the rule of law by conducting the business of government in accordance with the framework established in the United States Constitution. And it is about keeping the power to resolve purely local concerns as close to the people affected by the decisions as possible.

But American federalism is about more than legitimacy: it is also about good government. As Justice Louis Brandeis famously noted more than seventy years ago, "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country."[5] In other words, by allowing states to experiment with different solutions to social problems, we can view the comparative costs and benefits of each state's approach to particular issues before deciding whether a national solution is warranted or what form a national solution might take.

Our federal system not only allows states to serve as "laboratories of democracy," it fosters competitive enterprise.[6] Under our constitutional regime, states must compete for citizens and businesses in a way that causes each to try and maximize the returns. As Michael Greve of the American Enterprise Institute has noted, the variations in the "regulatory packages" offered by different states create options for both the citizens and businesses, both of which can vote with their feet if they do not like the public policies offered by the state where they are currently located.[7] This competition between states for citizens and businesses acts as a check on state power—it makes government more responsible and, indeed, more responsive to the concerns of the public.[8]

As Greve explains, federalism helps to reduce government's inefficiencies and spur public policy innovation, while at the same time allowing our large and complex nation to "manage our differences—on economic and especially social issues—in a sensible manner."[9]

B. Federalism's New Critics

The propositions outlined above are not especially controversial—indeed, they are the stuff of basic texts on U.S. government. Unfortunately, however, "federalism" has recently become a term that some activists use with hostility and contempt.

Federalism's new critics charge that the theoretical bases for federalism fail to consider the actual "real world" consequences of the doctrine.[10] They note, accurately, that in invoking basic principles of federalism, the U.S. Supreme Court has recently invalidated federal laws prohibiting guns near schools [11] and laws aimed at protecting women from domestic violence.[12] The new critics of federalism claim that such decisions represent a concerted effort to "imperil" civil rights, and they describe a parade of horribles that will befall America if federal courts continue to adhere to federalist principles.[13] Yet even a brief look at some of the cases complained of by the opponents of federalism reveal such claims to be hollow.

• *United State v. Morrison* (2000) [14]—In *Morrison*, the Supreme Court struck down as unconstitutional a provision of the Violence Against Women Act (VAWA) which provided a federal civil remedy to victims of domestic abuse. The case stemmed from a lawsuit filed in 1996 by a female college student against her school and two male students over an incident that allegedly had occurred in the male students' dormitory room in September 1994. In rejecting the student's claim, the Supreme Court held that Congress lacks authority under the Commerce Clause of the U.S. Constitution to regulate conduct that is neither "interstate" nor "commerce." The Court reasoned that, while domestic violence might have an economic impact, such crimes do not substantially affect interstate commerce so as to fall within the regulatory power bestowed on Congress by the Constitution. The Court rejected plaintiff's argument that the aggregate, long-term, economic affect of crime on interstate commerce made VAWA a valid exercise of Congressional power. And with good reason. Had the Court accepted such an argument, it would have given Congress the green light to regulate any and all areas of American life—for surely any activity, when aggregated, can be said to affect interstate commerce. Upholding the civil remedy portion of VAWA would have eliminated all limits on federal power and intruded upon traditional state prerogative: the regulation of local crime. The Court also found no constitutional authority for VAWA in Section 5 of the Fourteenth Amendment of the U.S. Constitution, because the statute sought to regulate purely private conduct, and not the state action contemplated by that Amendment.

• *United States v. Lopez* (1995)[15]—*Lopez* involved a chal-

lenge to the Gun-Free School Zones Act of 1990, which made it a federal crime to possess a gun within 1,000 feet of a school. The Supreme Court invalidated the law, holding that "the Act exceeds the authority of Congress 'to regulate Commerce… among the several States.'"16 Writing for the Court, Chief Justice William H. Rehnquist stated that the decision was grounded in the constitutional "first principle" of enumerated powers. The law in question exceeded those powers because it "neither regulates a commercial activity nor contains a requirement that the possession be connected in any way to interstate commerce."[17]

Contrary to outraged criticisms by some liberal and feminist special interest groups, the *Morrison* and *Lopez* decisions were not defeats for victims of crime. Local crimes, of the sort Congress addressed in the statutes described above, are, by definition, inherently local problems, which state officials prosecute day in and day out. Victims of crime have available to them a variety of state civil and criminal remedies, none of which were eliminated or eviscerated by the cases at issue here, and there is simply no credible evidence that the states lack the will or the institutional competence to address these social ills. Considered in context, then, *Morrison* and *Lopez* represent, not a threat to civil rights, but rather important victories for the principles of institutional legitimacy and limited government.

C. Do the Supreme Court's Federalism Decisions Undermine the Principle of Judicial Restraint?

Federalism's new critics are fond of arguing that the Supreme Court's recent federalism decisions represent a departure from accepted constitutional jurisprudence and that such decisions are examples of judicial over-reaching, of judicial activism at its worst. For example, Simon Lazarus has recently argued that "a new constitutional philosophy has attracted numerous adherents on the political right . . . . In the name of an elaborate if quirky theory of 'federalism,' this group targets the [power of] Congress itself."[18] Likewise, an article on the website of the NOW Legal Defense and Education Fund equates federalism with "unprecedented judicial activism."[19] As explained previously, however, this critique confuses the concepts of judicial activism with that of judicial review.

"Judicial review"—that is, the power of federal courts to review laws to determine their consistency with the United States Constitution—is an essential element of our constitutional order. Under our constitutional system, courts are required to police the boundaries established by the Constitution. As Alexander Hamilton explained in the Federalist Papers, the "courts of justice are to be considered as the bulwarks of a limited Constitution against legislative encroachments" (Federalist 78). The Supreme Court of the United States is the ultimate authority on the constitutionality of Congressional acts.[20]

Federalism is not a made up theory, but one that is deeply enshrined in our Constitution. When courts act to enforce the structural provisions of our Constitution, they are exercising the power of judicial review and, in so doing, are acting as a check on the legislative branch. Federal courts may properly invalidate a law, or portion of a law, which conflicts with express constitutional provisions, or which the court concludes Congress lacked the constitutional authority to enact. This is not "judicial activism." To the contrary, the act of invalidating an unconstitutional law represents respect for the existing constitutional order. Courts only act outside the scope of their authority (and, thus, exhibit "judicial activism") when they create new rights out of whole cloth or invalidate a statute without a colorable basis in the text of the Constitution.[21]

Adherence to federalist principles is essential for at least two important reasons. First, if our Constitution is to mean anything at all, the boundaries between state and national power must be respected. If courts ignore the basic governmental structure enshrined in the Constitution, then there is certainly no reason for courts to respect the rest of text, including the Bill of Rights. Thus, courts must strive to adhere to federalist principles, not out of some nostalgic yearning for "states' rights," but in order to preserve the rule of law. As even Professor Laurence Tribe has acknowledged:

> The issue is not whether federalism is a popular notion, or whether its proponents are in step with the zeitgeist, but whether principles of federalism are implicit in our national charter. If tacit postulates of federalism are indeed ingrained in the Constitution, courts are not free to dismiss them out of hand as ghosts or spirits in which no one any longer believes.[22]

Second, as a substantive matter, federalism expands—rather than limits—American liberty. Although the Constitution and its amendments guarantee certain rights and freedoms (*e.g.*, freedom of the press, freedom of religion, the right to equal protection of the laws), it does not (indeed, cannot) anticipate and guarantee all conceivable liberties. State and local governments, however, are free to expand upon the liberties guaranteed by the federal Constitution and provide additional rights and guarantees to their citizens—rights for which there might not currently be, and indeed may never be, a national consensus.

For example, although the federal government does not guarantee the right to educational choice and opportunity, state and local governments are free to provide expanded educational choices through democratically enacted voucher programs. Likewise, state and local governments may—and, indeed, often do—enact civil rights laws that go well beyond the scope of federal protections. Thus, while the Equal Protection Clause of the U.S. Constitution has been interpreted as prohibiting discrimination on the basis of certain characteristics—primarily race, ancestry, and sex—many state and local governments extend such protections to other categories of citizens. The city of San Francisco, for example, has passed an ordinance prohibiting discrimination on the basis of weight and height.[23] Many state and local jurisdictions have passed laws prohibiting discrimination on the basis of sexual orientation.[24] In this way, federalism allows us to resolve complicated issues of social policy in ways that are

most consistent with local mores, while at the same time allowing us to experiment with expansions of liberty that may or may not stand the test of time.

It is simply untrue that federalism remains a code-word for a "pre-Civil War vision of states' rights"[25] in which the national government would be rendered powerless to protect civil rights. The amendments to the United States Constitution passed in the aftermath of the Civil War and the laws enacted thereunder make this impossible. Although our Constitution may not (as certain activists would like) enshrine an ever-expanding notion of "civil rights," it does empower the federal government to prohibit many forms of government-sponsored and private discrimination. Thus, contrary to critics' claims that federalism is inconsistent with constitutional protections of civil rights, the more accurate reading of the Constitution, and the one which best preserves American liberty, is the one that harmonizes federalism and the post-Civil War amendments. This reading of our Constitution is the best way to preserve American freedom.

* * *

The Alliance for Justice, through its Judicial Selection Project, has openly urged Senators to block qualified nominees on the basis of political ideology and judicial philosophy —particularly adherence to federalist principles. The NOW Legal Defense and Education Fund has launched a "Project on Federalism" which seeks to discredit any judicial nominee who is committed to preserving our federal system. And, along the same lines, the Democratically controlled Senate Judiciary Committee held hearings in June 2001 entitled "Should Ideology Matter? Judicial Nominations 2001." The hearings, which were intended to establish a factual and theoretical predicate for opposing the President's judicial nominees and to provide political cover for Senators who obstruct the confirmation process on the basis of ideology, featured the testimony of Marcia Greenberger of the National Women's Law Center, who urged the Senate to reject judicial nominees who fail to demonstrate a "commitment on key [women's] issues." [27]

Efforts by special interest groups to derail nominees committed to judicial restraint and federalism and to pack the courts with judges committed to a particular policy agenda do more than just imperil the operations of the federal courts and the rights of individual litigants. They imperil America's system of representative self-government and undermine our existing constitutional order. In order to prevent any further erosion of our constitutional system, we must insist that judges resist the temptation to wield their judicial power for political ends. Appointing and confirming judges who subscribe to principles of federalism and judicial restraint are the best means of securing all of our liberties.

*Jennifer C. Braceras teaches federal anti-discrimination law at Suffolk Law School in Boston, Massachusetts and serves as a Commissioner on the United States Commission on Civil Rights. This article is adapted from a paper originally published by the Independent Women's Forum in October 2002 and is reprinted with the permission of the IWF. The complete document can be downloaded from the IWF Website at www.IWF.org.

Footnotes

1. *See generally* Alexander Bickel, *The Least Dangerous Branch* (1962) (explaining that judges should exercise the "passive virtues" of restraint and humility and must not impose their own values upon the people); John Hart Ely, *Democracy and Distrust: A Theory of Judicial Review* (1980) (judges deciding constitutional cases should limit themselves to enforcing norms that are clearly stated or clearly implicit in the text).
2. *See generally* Bickel, *supra* note 1 (explaining that the counter-majoritarian impulses of the federal courts threaten the judiciary's legitimacy).
3. *Coalition for Economic Equity v. Wilson*, 122 F.3d 692, (9th Cir.), cert. denied, 522
U.S. 963 (1997).
4. *United States v. Morrison*, 529 U.S. 598 (2000).
5. *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).
6. *See* Michael S. Greve, "A Federalism Worth Fighting For: Conservatives Should Stop Getting Bogged Down in States' Rights," *The Weekly Standard* at 28 (January 29, 2001).
7. *Id.* at 28; *see also* Michael W. McConnell, "Federalism: Evaluating the Founders' Design," 54 *U. Chi. L. Rev*. 1484, 1503 (1987) (explaining that "oppression at the federal level is more dangerous [than oppression at the state or local level because] it is more difficult to escape. If a single state chose, for example, to prohibit divorce, couples seeking a divorce could move [or perhaps merely travel] to other states where their desires can be fulfilled. Oppressive measures at the state level are easier to avoid. Important recent examples of this phenomenon are the migration of homosexuals to cities like San Francisco, where they received official toleration, and the migration of individuals from Massachusetts to New Hampshire to escape high rates of taxation.").
8. Greve, *supra* note 6; *see also* McConnell, *supra* note 7 at 1499 (arguing that "state and local governmental units will have greater opportunity and incentive [than will the national government] to pioneer useful changes. A consolidated national government has all the drawbacks of a monopoly: it stifles choice and lacks the goal of competition.").
9. Greve, *supra* note 6.
10. *See*, *e.g*., NOW Legal Defense and Education Fund, "Project on Federalism: The Threat of Federalism," available at www.nowldef.org/html/issues/fed/simple.htm (visited March 21, 2002) (hereinafter, "Project on Federalism").
11. *United States v. Lopez*, 514 U.S. 549 (1995).
12. *United States v. Morrison*, 529 U.S. 598 (2000).
13. See *e.g*., Isabelle Katz Pinzler, "High Court's Philosophy Imperils Women's Rights," *Women's ENews*, (NOWLDEF, July 11, 2001), available at www.womensenews.com/article.cfm/dyn/aid/611/ context/archive (visited July 30, 2002).
14. 529 U.S. 598 (2000).
15. 514 U.S. 549 (1995).
16. *Id*. at 551.
17. *Id* at 552 & 551.
18. Simon Lazarus, "Don't be Fooled. They're Activists Too," *The Washington Post* at B3 (June 3, 2001).
19. Project on Federalism, *supra* n. 10.
20. *See Marbury v. Madison*, 5 U.S. 137 (1803).
21. *See generally* Alexis de Toqueville, *Democracy in America* 96 (2000) (Harvey C. Mansfield and Delba Winthrop, eds.) (observing that "In the United States, the Constitution dominates legislators as it does plain citizens. It is therefore just that the courts obey the Constitution in preference to all laws.").
22. Laurence H. Tribe, *American Constitutional Law* 400 (2d ed. 1988).
23. *See* "Jazzercise Settles Weight Bias Suit," *Associated Press Online* (May 8, 2002) (describing the San Francisco ordinance and a lawsuit brought to enforce the law).
24. *See e.g*., Mass. Gen. L. ch. 151B (prohibiting Massachusetts employers from discriminating on the basis of sexual orientation).
25. *See* Project on Federalism, *supra* note 10 at 2.

Corporations

The Friendly Neighborhood Trade Commission

By Montgomery N. Kosma

In some sectors of our economy, the rise of Internet commerce has prompted a dramatic response: do anything possible to keep out online price cutters! Many traditional local vendors feel threatened by online merchants who can take advantage of scale economies and avoid the overhead of an in-state storefront. In many instances, they have turned to the state government for legislative or administrative protection from that competition. Such measures are often hostile to free markets, limiting price competition and restricting consumer choice and convenience. They also clash with the constitutional principle of federalism which enjoins the states from unjustifiably interfering with interstate commerce. Under the leadership of Chairman Timothy Muris, the Federal Trade Commission has recognized these trends and responded strongly with the voice of national, federal competition policy in cases where consumer interests appear to be threatened.[1]

For some time, the principal devotees of federalism have focused on policy initiatives and litigation to restrain the federal government's encroachment on the rights, powers, and sovereignty of the states. But there is a flip side to federalism that requires states to refrain from interfering with national interests committed to federal authority. When local or regional conduct is at issue, there may be some value to having heterogeneous legal standards that result from each state operating as an independent "laboratory of democracy." However, when it comes to national or international economic regulation, leaving legal rules up to the experimentation of the states invites rent-seeking, inefficiency, and uncertainty, and leads almost inevitably to a system in which the most restrictive state regulations define the *de facto* national standard. One can easily imagine the chaos that would ensue if, for example, the states could individually regulate the issuance and enforcement of patents.

The Constitution provides some assistance in countering protectionist actions by the states. As James Madison recognized in Federalist No. 10, one of the principal justifications for an extended republic was to reduce the power of factions seeking government action in order to advance their own interests rather than the broader public good. Consistent with this principle, ever since *Gibbons v. Ogden* was decided in 1824, the Supreme Court has (rightly or wrongly) found within the Constitution's Commerce Clause a "dormant" restriction against state regulation of interstate commerce. The Court has applied this doctrine as a limit on the states' police power. State laws, regulations, and administrative actions that nakedly discriminate against out-of-state competitors are generally subjected to strict scrutiny, and in most cases have been struck down. Naturally, such a legal standard creates incentives for cleverness. Thus, most dormant commerce clause cases today involve facially neutral regulations or actions that ostensibly serve some legitimate local public interest, but which have a disparate impact upon out-of-state competitors. In such cases, the Court applies a balancing test, asking whether the burden on interstate commerce is clearly excessive in relation to the putative local benefits.

Nevertheless, litigation under the dormant commerce clause is frequently inadequate to protect competition. A clever state or municipality can cloak protectionist measures in the garb of legitimate public interest, making judicial challenge difficult and costly. Because of this need for justification, some of the most pernicious protectionist measures affect businesses that have been traditionally subjected to state licensing for legitimate reasons of public health or safety. Because states generally enjoy immunity from the antitrust laws pursuant to the Supreme Court's 1942 decision in *Parker v. Brown*, Courts are chary of upsetting such regulations. Notwithstanding *Parker*, principles of federalism counsel deference to states, and principles of separation of powers counsel deference to legislative or administrative policymakers. Litigation is a costly and risky process, and even if judicial relief can be obtained, it may not be sufficient or timely enough to redress all of the harm.

Enter the FTC. Chairman Muris and Ted Cruz, the Director of the FTC's Office of Policy Planning, have recognized that their agency can wield not just the power of compulsion, but also the power of persuasion. Where it has judged that the threatened harm to competition (*i.e.*, decreasing consumer choice or increasing prices) outweighs the supposed public benefits ascribed to a proposal, the FTC has taken affirmative steps to make its views known by filing letters, comments, and testimony in state regulatory proceedings.

For example, Connecticut's Board of Examiners for Opticians is conducting a declaratory proceeding to determine whether Connecticut law requires optician licenses for all vendors that sell contact lenses in the state. Supporters of the requirement contend that patients should be required to obtain contact lenses from a licensed provider – typically, the doctor who prescribes the lenses – in the interest of patient health. Medical supervision of the use of contact lenses is important to prevent eye problems, to ensure that patients adhere to doctors' usage instructions and to spot emerging health problems at an early stage. On the other hand, a licensing requirement would prevent most stand-alone sellers of replacement contact lenses (such as 1-800-CONTACTS) from conducting business within the state. The FTC provided written comments and oral testimony to the

Board, contending that the proposed interpretation would severely restrict competition by Internet, telephone, and mail order sellers of contact lenses, and that the purported health interests are already adequately protected by other state and federal regulations, such as the requirement for a doctor's prescription. Thus, the proposal would harm consumer welfare by increasing prices and reducing convenience, with little or no offsetting public benefit. Although Connecticut has not yet issued a decision in its proceeding, at least some of the barriers to competition may be coming down: according to FTC staff, Alaska changed its policy to allow online contact lens sales after reading the FTC filing in the Connecticut proceeding.

As another example, the FTC has recently opposed state actions that effectively limit the ability of Internet-based mortgage lenders to conduct business in North Carolina and Rhode Island. In North Carolina, the State Bar adopted two opinions requiring the physical presence of attorneys at closings for all residential real estate purchases and refinancings. In Rhode Island, the House of Representatives was considering a bill to prevent non-lawyers from competing with lawyers to perform real estate closings. The FTC filed comments with authorities in both states, and provided oral testimony in North Carolina, noting the rule's disparate impact on online mortgage brokers who more frequently rely upon "lay" closers rather than attorneys with a physical presence in the state.[2] In each case, the FTC pointed out the lack of support for the assumption that consumers are at risk in transactions without attorneys, and marshalled empirical evidence based on the experience in other states to demonstrate that the proposed rules could raise closing costs by $150 to $500 per transaction. As a result, the North Carolina State Bar has promulgated proposed formal ethics opinions substantially reversing its prior position. At last report, the Rhode Island bill had been returned to committee for further consideration.

Although to date the FTC has been reluctant to get involved in dormant commerce clause litigation, it has been closely following various cases and recently held a public workshop relating to possible anticompetitive efforts to restrict competition on the Internet. The FTC also filed an *amicus* brief in a federal court case in which private plaintiffs, represented by the Institute for Justice, challenged Oklahoma's requirements that sellers of caskets be licensed funeral directors. In its filing, the FTC clarified that the purpose of the FTC's Funeral Rule was to permit sellers other than funeral directors to compete for casket sales, and that the rule did not support the state's position that all suppliers of funeral goods should be subject to the same regulation. However, the FTC expressly declined to take any position on the merits of the dormant commerce clause and other arguments advanced by the plaintiffs. In the days ahead, we should see continued FTC interest in such cases, but unless something changes in its willingness to address constitutional issues, we should expect *amicus* involvement only when a case presents some element of traditional FTC interest or expertise (*e.g.*, a longstanding FTC consumer protection rule or a doctrine like *Noerr-Pennington* immunity from antitrust liability for conduct that constitutes governmental petitioning).

In his recent remarks at the Federalist Society's National Lawyers Convention, Chairman Muris recognized that "a well-ordered federalist system must be concerned not just with an overreaching federal government, but also with preventing states from encroaching on each other." The advent of online commerce has brought with it a new wave of proposals for states to protect local vendors at the expense of Internet-based competitors – and at the expense of competition. The FTC's affirmative efforts to inject itself into these debates as an advocate for competition adds a powerful voice to address national interests. And significantly, it moves this particular federalism debate somewhat away from the realm of constitutional law. Because of countervailing federalism principles and the potential consequences of an activist approach to the Constitution, courts have been naturally hesitant to strike down state regulations as unconstitutional under the dormant commerce clause. Indeed, good economic policy without more is probably an insufficient basis for such coercive judicial action. So it is encouraging to see the FTC making efforts to advocate sound economic policy and thereby defend the competitive marketplace, although it is probably too soon to judge how effective its efforts will be.

In cases or other public disputes that implicate such issues, the wise advocate will remember that the FTC continues to seek opportunities to speak as an advocate for competition, and its opinion can carry substantial weight if and when placed on the scales of justice. Ted Cruz has specifically invited the public to contact the FTC's Office of Policy Planning regarding situations in which the persuasive rather than the coercive weight of the agency might effectively be brought to bear. We should expect to see FTC involvement in more cases, and in more types of cases. Among other things, be on the lookout for the FTC to intervene in a consumer class action, arguing that a settlement ostensibly in consumers' interests is actually hostile to free markets.

* Montgomery N. Kosma is an attorney with Jones Day, and the co-chairman of the Antitrust Subcommittee of the Federalist Society's Corporations Practice Group.

Footnotes

[1] *See Possible Anticompetitive Efforts to Restrict Competition on the Internet:* Federal Trade Commission Public Workshop (Oct. 8-10, 2002), available at http://www.ftc.gov/opp/ecommerce/anticompetitive/index.htm.

[2] The FTC also recently filed comments with the American Bar Association's Task Force on the Model Definition of the Practice of Law, arguing that the ABA's broad definitional proposal would have a chilling effect on competition by lay service providers and ultimately raise prices to consumers.

Producing Inefficiency: The Perishable Agrigultural Commodities Act

*By Michael Anthony Shaw**

Originally enacted in 1930, the Perishable Agricultural Commodities Act ("PACA") was intended to protect the interests of producers of perishable agricultural commodities when they bring their products to market. Over the course of five decades, it proved difficult to enforce the provisions of PACA as drafted and codified. Therefore, in the 1980s Congress determined to strengthen PACA, creating iron-tough statutory provisions in favor of producers of perishable produce, and simultaneously causing great difficulties for already-struggling purchasers of perishable produce. The most severe provision of the revised PACA virtually eliminates any possibility of a debtor produce company reorganizing under the U.S. Bankruptcy Code by imposing a trust on purchased produce and the proceeds thereof. Another provision of PACA, almost equally harsh for the modern-day produce business, is the ability of creditors under PACA to pursue claims against a debtor corporation's directors and officers if the creditors are unable to collect from the corporation itself. Therefore, PACA puts produce distributors at a double disadvantage compared to companies in other industries: bankruptcy reorganization is virtually eliminated as a possibility for a struggling company, and management (assuming that competent leaders can be found who are willing to bear this risk) is threatened with the possibility of industry-specific personal liability on the company's debts. As a result, in our current economy a struggling small or mid-level produce business stands virtually no chance of surviving through difficult periods. Congress should consider revisiting PACA to eliminate these provisions, and should seek an alternative means, such as a purchase-money security interest, to protect producers.

PACA and Its History

The purpose of PACA when it was first enacted by Congress in 1930 was, according to a more recent Congress, "to encourage fair trading practices in the marketing of perishable commodities by suppressing unfair and fraudulent business practices in marketing of fresh and frozen fruits and vegetables and cherries in brine and providing for collecting damages from any buyer or seller who fails to live up to his contractual obligations."[1] PACA's mechanism for promoting fair trading practices was to establish licensing procedures for participants in the produce industry, thereby providing sellers of produce with certain limited protections. In the early 1980s, Congress judged that the 1930 version of PACA lacked the enforcement provisions necessary to realize PACA's goal of fair trade and practices in the industry, and determined to strengthen these provisions. Congress believed that delayed payment was endemic in the perishable agriculture commodities market, and that there had been numerous instances of outright failure to pay.[2] The amended PACA attempted to solve these problems by impressing a trust upon perishable agricultural commodities that are received by purchasers.[3] Therefore, when a seller sells produce to a buyer (such seller and buyer referred to hereinafter as a "Produce Creditor" and "Produce Debtor," respectively), the produce sold, as well as any receivables or proceeds generated from that produce, is considered to be held in trust until the Produce Creditor is paid for the produce.[4] The amended PACA thereby created a "nonsegregated floating trust made up of all the firm's commodity-related liquid assets, under which there may be a co-mingling of trust assets."[5] The reason for creating this trust mechanism was Congress's perception that when a Produce Debtor went into financial difficulty, its secured creditors (e.g., lenders) were able to move quickly to claim their money, while Produce Creditors were not able to move as quickly, due to the fact that Produce Creditors tend to have less information about Produce Debtors, updated less frequently, than do lenders, and also are often located at a great distance from Produce Debtors.[6] Therefore, by the time a Produce Creditor could discover the Produce Debtor's business difficulties and attempt to retrieve the funds it was owed, the Produce Debtor's assets could already have been dissipated among the other creditors.[7] Under the new system, the produce and its proceeds are held in trust, and these trust assets are frozen until such time as the Produce Creditors have had the opportunity to make a claim on the funds they are due.[8] Other creditors are not able to levy on the trust assets, because the Produce Debtor is not their beneficial owner. By enacting these amendments to PACA, Congress intended to "reduce the difficult burden on commerce" which they believed resulted from the inability of Produce Creditors to collect the debts owed them.[9] Now, a Produce Creditor has the ability to recover money that it is owed even if the money has already been paid to a non-trust creditor, including non-trust creditors with otherwise-superior claims.[10]

In making life easier for Produce Creditors, however, the enactment of these new provisions to PACA in 1983 made life much more difficult for Produce Debtors. The primary difficulty added by these provisions were the new effective restrictions on a Produce Debtor's ability to reorganize when there are PACA claims in existence.

Bankruptcy Implications of PACA

The United States Bankruptcy Code provides a mechanism by which a business suffering from financial difficulties can reorganize in order to operate productively in the future, or, if this is impracticable, by which a systematic, orderly, and fair distribution of a bankrupt company's assets can be ensured. By allowing companies to reorganize through bankruptcy, the hope, in the words of the Supreme Court, is that a company "would continue to provide jobs, to satisfy creditor's claims, and to produce a return for its owners."[11] The Bankruptcy Code thus implicitly recognizes the "going concern" value of a business: a debtor's assets are generally

more valuable if used in a productive business than if broken up and sold piecemeal. The Supreme Court goes on to say that "the reorganization effort would have small chance of success, however, if property essential to running the business were excluded from the estate . . .. Thus, to facilitate the rehabilitation of the debtor's business, all the debtor's property must be included in the reorganization estate."[12]

The problem with PACA is that it prevents Produce Debtors from taking advantage of these fundamental aspects of a reorganization, virtually shutting the door on any possibility of successful reorganization and reemergence as a successful company. This is because under the Bankruptcy Code, property that is considered to be held in trust is excluded from an estate in bankruptcy.[13] As one bankruptcy court put it, "where trust benefits are properly preserved, a debtor merely holds legal title in trust for the sellers. The equitable interest in the property remains outside the estate. . . . Therefore, the beneficial interest in the assets subject to a PACA trust never become property of the estate."[14] Thus, a Produce Creditor, as beneficiary of a PACA trust, is guaranteed that it will be able to levy in full from all assets subject to the trust before any other creditor can look to such assets for payment.[15] The PACA bankruptcy trusts have been "universally recognized" to exclude all trust property from a bankruptcy estate.[16]

Therefore, a produce company which is in financial difficulty, and which has any significant debts covered by PACA (as almost all do, by the nature of their business), has no realistic hope of reorganization under the Bankruptcy Code. Under these PACA rules, not only are all proceeds of sale of the produce included in the trust excluded from the bankruptcy estate, but so are all other properties and assets purchased with such proceeds. Thus, to the extent purchased or paid for with trust funds, a company's trucks, cash, property, and additional produce, as well as other assets, can be excluded from the bankruptcy estate, reachable in the first instance only by the Produce Creditor.[17]

Bankruptcy courts in some jurisdictions have held that this would even allow a Produce Creditor to retrieve money from the employees of a Produce Debtor if the employees' salaries came from trust assets.[18] The inability to reorganize in bankruptcy, or even to guarantee to your employees that they will be able to keep their wages, places produce distributors in a precarious position. However, PACA's anti-commerce provisions extend beyond the bankruptcy realm and provide for the possibility of harsh penalties against individuals within a produce corporation, virtually eliminating the protection from liability normally enjoyed by agents acting within the scope of their employment.

Personal Liability Under PACA

Normally, an agent acting lawfully and in the course of his agency, including an officer or director of a corporation, is not personally liable on contracts he enters into on behalf of his principal/employer. Under PACA, however, an individual officer or director of a Produce Debtor can, in some circumstances, be held personally liable to a Produce Creditor.[19] Therefore, if a produce company is unable to pay its produce debts, and the trust assets remaining in the company or practicably traceable are insufficient to reimburse the Produce Creditors, the Produce Creditors can file suit against individuals within the debtor corporation, in their personal capacities, in an attempt to obtain the money they are owed. In the words of one Federal court, "case law generally holds that an individual in control of PACA trust assets may be liable for failure to preserve the *res* of the trust without regard to whether the failure was intentional or whether the individual was an otherwise responsible corporate officer."[20] This cannot fail to create an enormous disincentive for anyone to manage a produce-distribution company. Under PACA, there is essentially no defense mechanism left for the corporation or for the individuals running the corporation.

Conclusion

As discussed above, all proceeds of sales of produce, which often constitute virtually the entire revenue of a produce company, as well as all property generated from such proceeds, are considered to be held in trust under PACA for the benefit of Produce Creditors, and are therefore excluded from the Produce Debtor's bankruptcy estate. Since the Produce Creditors are not obligated to cooperate with any reorganization plan, and have little incentive to do so, the possibility of a Produce Debtor successfully reorganizing in bankruptcy is effectively non-existent. The Produce Debtor's funds can be distributed among the various Produce Creditors, and if one of them fails to receive all the funds that it is owed, as may often be the case, given that the company cannot (by hypothesis) pay its debts in the first place, then those Produce Creditors can go after the individuals running the corporation. This could in turn force the individuals to file for bankruptcy in an attempt to protect their personal assets. Moreover, as noted earlier, in certain jurisdictions payroll money received by employees of a Produce Debtor can sometimes also be reclaimed by a Produce Creditor. Therefore, all the money made by the individuals within the company, if such money can be shown to come from the trust assets, can possibly be reclaimed by the Produce Creditors. And because it is deemed trust money, these funds could be deemed outside of the bankruptcy estate when the individual files personal bankruptcy as well. Therefore, a situation is created under the current PACA provisions where neither a company, nor an individual officer or director, has any margin for error. In the current state of the produce market and the economy generally, a Produce Debtor has very little margin for error to begin with. PACA reduces that margin until it is close to zero, and makes it very difficult for a Produce Debtor to raise capital, attract and maintain employees, and grow and develop as a corporation over time.

The 1983 amendments to PACA overcompensated for the enforcement problems Congress was attempting to remedy. Far from aiding the produce market, a substantial new burden on commerce has been created by eliminating

virtually all protections for produce distributors. If it is indeed the case that some market failure renders Produce Creditors unable to protect their legitimate claims using the same legal tools available to creditors generally, Congress should consider replacing the trust mechanism and personal liability enacted in 1983 with some more balanced means of protecting Produce Creditors. One potential solution that comes to mind is to make use a form of security interest, either under Article 9 of the Uniform Commercial Code or sui generis, that would place Produce Creditors in the position of secured creditors with respect to the produce they supply, proceeds of its sale, and proceeds of proceeds. That way, Produce Creditors would be put on the same footing as the banks and lenders that Congress originally thought had an unfair advantage, without the perverse consequences of PACA in preventing reorganization and victimizing employees of Produce Debtors.

* Michael Anthony Shaw is an Associate with Luther, Oldenburg & Rainey in Mobile, Alabama.

Footnotes

[1] H.R. Rep. No. 98-543, at 3 (1983), *reprinted in* 1984 U.S.C.C.A.N. 405.
[2] *See id.*
[3] 7 U.S.C. § 499(e)(c); *Middle Mountain Land & Produce, Inc. v. Sound Commodities, Inc.,* 307 F.3d 1220, 1224 (9th Cir. 2002).
[4] 7 U.S.C. § 499e(c)(2).
[5] H.R. Rep. No. 98-543, *supra* note 2, at 5.
[6] *Id.* at 7.
[7] *Id.*
[8] *Id.*
[9] *Tanimura & Antle, Inc. v. Packed Fresh Produce, Inc.,* 222 F.3d 132, 135 (3rd. Cir. 2000).
[10] *C.H. Robinson Company v. Alanco Corp.,* 239 F.3d 483, 486 (2nd Cir. 2001).
[11] *U.S. v. Whiting Pools, Inc.,* 462 U.S. 198, 203 (1983).
[12] *Id.* (internal citations omitted).
[13] 11 U.S.C. § 541.
[14] *See In re Chipwich, Inc.,* 165 B.R. 135, 138 (Bankr. S.D.N.Y. 1994) (internal citations omitted).
[15] *See In re Long John Silver's Restaurants, Inc.,* 230 B.R. 29, 33 (Bankr. D. Del. 1999).
[16] *In re Churchfield,* 277 B.R. 769, 776 (Bankr. E.D. Cal. 2002).
[17] 7 U.S.C. § 499(e)(c); *In re Magic Restaurants, Inc.,* 205 F.3d 108, 111-112 (3rd Cir. 2000).
[18] *See In re Bear Kodiak Produce, Inc.,* 283 B.R. 577, 585-587 (Bankr. D. Ariz. 2002)(citations omitted).
[19] 7 U.S.C. § 499(e)(c); *Red's Market v. Cape Canaveral Cruise Line, Inc.*, 181 F.Supp.2d 1339, 1344-1345 (M.D. Fla. 2002).
[20] *Id.*

Recent Rulemaking Activity by the Securities and Exchange Commission Under the Sarbanes-Oxley Act of 2002

*By Peter L. Welsh**

The SEC has been extremely active lately on the rulemaking front, particularly with regard to the Sarbanes-Oxley Act of 2002 ("Sarbanes-Oxley" or "SOA"). Over the past six months, the Commission has issued no fewer than ten releases containing final rules promulgated pursuant to Sarbanes-Oxley, and eight Final Releases have been issued in the past three weeks alone. Additional proposed rules have yet to be finalized and the Commission is still seeking comment on certain proposed rules, including a proposed requirement that, under certain circumstances, attorneys practicing before the Commission effect a "noisy withdrawal" from representation of an issuer associated with material violations of the securities laws or breaches of fiduciary duty.

The rules promulgated pursuant to Sarbanes-Oxley represent a sweeping attempt by the Congress and the Commission to provide "protection" to investors against the consequences of corporate wrongdoing and fraud. The Act and the rules promulgated pursuant to the Act evidently seek to accomplish this end by a number of means. In particular, the final rules issued pursuant to the Act seek, first, to make violations of the securities laws less likely to occur than in the past by tightening the rules with respect to certain key disclosure issues and by compelling officers and directors to focus more intently on quality disclosure. For example, the final rules include heightened disclosure requirements for off-balance sheet financing as well as new rules governing the use of non-GAAP reporting. The final rules also impose certification and code of ethics disclosure requirements on senior financial and executive officers. Secondly, the final rules evidently seek to make detection of material violations of the law more likely occur. In that regard, the rules contain extensive requirements relating to auditor independence and the standards of professional responsibility for attorneys, as well as a prohibition on improper attempts to influence the conduct of an audit. Thirdly, the Act – though not the rules – significantly increases criminal and civil penalties for certain violations of the law affecting the securities markets. The Act, for example increases the maximum penalty for mail and wire fraud from five years to twenty years per violation.

The specific rules promulgated in the recent weeks and months by the Securities and Exchange Commission (herein the "SEC" or the "Commission") pursuant to Sarbanes-Oxley are as follows:

* * *

Title II/Section 208(a) – Auditor Independence

SOA – Sections 201 through 208 impose a number of restrictions on public company audit representations, including a general prohibition of a range of non-audit services (Section 201), strengthened auditor conflict of interest standards (Section 206), a requirement of auditor partner rotation and second partner review (Section 203), and enhanced standards governing the relationship between an issuer's audit committee and its independent auditor (Sections 202 and 204). Section 208 specifically directs the Commission to promulgate rules delineating these auditor independence standards.

Rulemaking Status – The Proposing Release was issued December 2, 2002 and the comment period expired January 13, 2003. The Final rules were issued January 28, 2003.

Summary –The amendments to the Commission's standards regarding auditor independence are lengthy and complex. The final rules effect changes principally to Regulation S-X and Regulation S-K.[1] and they generally cover three spheres of activity: (1) the relationship between issuer and audit engagement team; (2) the provision of non-audit activities by an issuer's auditors; and (3) the oversight role and responsibilities of the issuer's audit committee.

- "Cooling Off" Period and Audit Partner Rotation – The final rules require a "cooling off" period for an audit engagement team member wishing to go "in-house" at the audit client. 17 CFR § 210.2-01. The final rules also require regular rotation of audit engagement team partners on a particular client's account. Id. If these requirements are not met, the firm employing the audit engagement team in question would not be deemed to be independent of the issuer.

  - Mandatory "Cooling Off" Period – The final rules require that, to remain independent of the issuer, any member of an audit team who is a lead/concurring partner or who performs a minimum amount of audit and/or review services for an issuer must wait for at least one year after leaving the audit engagement team before they may assume a "financial reporting oversight" position with the issuer.

    - "Financial reporting oversight role" – The term is defined by the rules to apply more broadly than the Act and, in particular, is not limited to the positions of CFO, chief accounting officer or controller, as provided by the Act. See SOA at §206. Rather, the term refers to "any individual who has direct responsibility for oversight of those who prepare the registrant's financial statements and related information" and is intended by the Commission to apply more broadly to persons at the issuer other than the CFO, CAO and controller. Re-

lease No. 33-8183 at 6.

o Persons Covered – The rule applies to the lead partner, the concurring partner and to all members of the audit engagement team who have performed more than 10 hours of audit services for the issuer. 17 CFR §210.2-01; see also Release No. 33-8183 at 10.[2] If any of the forgoing takes a "financial reporting oversight" position prior to the expiration of the cooling off period, then the accounting firm formerly employing such person loses its independence as auditor of the issuer.

o Length of cooling off period – The mandatory cooling off period lasts for one entire audit cycle as determined by reference to the date of the filing of the issuer's annual report. 17 CFR § 210.2-01(c)(2)(B)(3). Each audit engagement period is deemed to commence on the day after the periodic annual report is filed. Id. The "cooling off" period must last for at least one such audit cycle. Thus, suppose, for example, an issuer's 2002 and 2003 annual reports will be filed on March 31, 2003 and March 31, 2004. In that case, the next annual audit cycle would not begin under the rule until April 1, 2003 and would not end until March 31, 2004. See Release No. 33-8183 7-10. If a member of the audit team provides audit, attest or review services at any time prior to March 31, 2003, he or she could not join the issuer in a "financial reporting oversight role" until at least April 1, 2004 without undermining the accounting firm's independence. Id.

· Mandatory Partner Rotation – The new rules provide that the lead partner and concurring partner on the audit team must rotate off of an account every five years and all other "audit partners" must rotate off of an account every seven years. 17 § CFR 210.2-01(c)(6)(A); see also Release No. 33-8183 at 47. The lead partner and concurring partner, moreover, must remain off of the account for a "time out" period of five years while other audit team members subject to the rotation requirement must remain off of the account for a "time out" period of two years. 17 CFR 210.2-01(c)(6)(B).

o "Audit partners" subject to the rotation requirements are defined by the Rule to include partners on the engagement team who have significant responsibility for audit, accounting or reporting decision-making or who are in regular contact with the issuer's audit committee or with management. Release No. 33-8183 at 47. The term "audit partners" specifically excludes all partners serving a subsidiary (including the lead partner on those subsidiary) where the subsidiary makes up less than 20% of the issuer's assets and revenues. For subsidiaries making up more that 20% of the issuer's assets or revenues, only the lead partner is subject to rotation; all other partners serving the subsidiary are not subject to the rotation requirement. Id. The term "audit partner" also excludes specialty partners and "national office" partners. Id. at 48.

◆ General Prohibition on Non-Audit Services — The cornerstone of Title II of the Act is a prohibition against accounting firms performing a range of "non-audit" services to their audit clients. The final rules likewise generally prohibit the provision of such services to audit clients. The Commission notes in the release accompanying the final rules that "[t]he Commission's principles of independence with respect to services provided by auditors are largely predicated on three basic principles, violations of which would impair the auditor's independence: (1) an auditor cannot function in the role of management, (2) an auditor cannot audit his or her own work, and (3) an auditor cannot serve in an advocacy role for his or her client." Release No. 33-8183 at 18.

· Specific Services Covered – Like the Act, the final rules generally prohibit accounting firms from providing the following "non-audit" services to an audit client: (i) Bookkeeping services; (ii) financial information systems services; (iii) Appraisal, valuation services or fairness opinions; (iv) actuarial services; (v) internal audit services; (vi) management functions; (vii) human resources services; (viii) broker dealer, investment advisor or investment banking services; (ix) legal services; and (x) certain expert services. 17 CFR §210.2-01(c)(4)(i)-(x); Release No. 33-8183 at 20-39.

· Limited Ban on Certain Services – The final rules further provide that: (i) bookkeeping services; (ii) financial information systems services; (iii) appraisal, valuation, fairness opinions; (iv) actuarial services; and (v) internal audit outsourcing may not be provided "unless it is reasonable to conclude that the results of these services will not be subject to audit procedures during an audit of the audit client's financial statements." Release No. 33-8183 at 20-21.

· Tax Services Excepted – The release accompanying the final rules notes that "accounting firms have historically provided a broad range of tax services to their audit clients." Generally, the final rules permit audit firms to continue to provide tax compliance, tax planning and tax advice services — to its audit clients. Release No. 33-8183 at 40.

- Audit Committee Oversight – The final rules require the prior review and approval by the audit committee of all permissible non-audit services and all audit engagements. 17 CFR § 210.2-01(c)(7). The final rules generally require that the audit committee review and approve all services provided by the firm's auditors but permits the audit committee to establish its own policies and procedures for approving the services.[3]

Section 302(a) – Corporate Responsibility for Financial Reports

SOA – The Act requires that the Commission issue rules requiring that the chief executive officer and the chief financial officer certify in each quarterly and annual report that: (i) the certifying officer has read the report; (ii) based on the officer's knowledge, the report does not contain any material misstatements or omissions; (iii) based on the officer's knowledge, the financial statements, and other financial information included in the report, fairly present the result of operations of the issuer; (iv) the officers are responsible for establishing and maintaining internal controls and have, in fact, designed such internal controls to ensure that material information is made know to the certifying officers, particularly during the period when the reports are being presented; (v) have evaluated the effectiveness of the internal controls within the 90 days prior to the report; (vi) have stated their conclusions about the effectiveness of the internal controls; (v) the certifying officers have reported to the issuer's auditors and to the audit committee of the issuer all material deficiencies in the design or operation of the internal controls and/or any fraud; and (vi) the certifying officers have disclosed whether any changes to the internal controls have recently been made that could affect the integrity of future financial reports of the issuer.

Rulemaking Status – The final rule was issued on August 29, 2002.

Summary – The final rule tracks the statutory provisions of Section 302 closely, albeit with one significant exception – the final rule substitutes a new term "disclosure controls and procedures" for the statute's "internal controls." The final rule also sheds some further light on the meaning of the Act's requirement that the CEO and CFO certify that the financial statements "fairly present" the financial results of the issuer.

- "*Disclosure Controls and Procedures"* – The final release explains that the Commission has developed a new concept to effectuate the intent of Congress in enacting Section 302. The new concept, "disclosure controls and procedures" encompasses a broader range of controls and procedures than the more conventional concept of "internal controls," already a part of the "books and records" provisions of Section 13 the Exchange Act and incorporated in Section 302 of the SOA. "Internal controls" refers generally to an issuer's control of its assets and its financial reporting. Release No. 33-8124 at 7-8. The new concept of "disclosure controls and procedures" includes a broader range controls and procedures than "internal controls," addressing the quality and timeliness of the issuer's disclosure of *both* material non-financial and financial, information. Release No. 33-8124 at 8.

- *"Fairly Presents"* – The release accompanying the final rule clarifies that "the certification statement regarding fair presentation of financial statements and other financial information is not limited to a representation that the financial statements and other financial information have been presented in accordance with generally accepted accounting principles and is not otherwise limited by reference to generally accepted accounting principles." Release No. 33-8124 at 8; U.S. v. Simon, 425 F.2d 796, 806 (2d Cir. 1969)(Friendly, J.)(Holding that expert evidence of compliance with GAAP is not sufficient to avoid criminal conviction for securities fraud and that expert testimony regarding GAAP is not dispositive on whether financial statements provided "fair presentation" of financial results of issuer).[4] Rather, "fair presentation" is understood by the Commission to mean that "the financial information disclosed in a report, viewed in its entirety, meets a standard of overall material accuracy and completeness that is broader than financial reporting requirements under generally accepted accounting principles."[5] Id.

Effective Time — The new rule became effective on August 29, 2002.

Section 303(a) – Improper Influence on Conduct of Audits

SOA — The Act provides that it "shall be unlawful . . . for any officer or director of an issuer to take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified accountant engaged in the performance of an audit of the financial statements of the issuer for the purpose of rendering such financial statements materially misleading." The Act directs the Commission to issue proposed rules within 90 days of enactment and to issue final rules or regulations not later than 270 days after the date of enactment.

Rulemaking Status — The Proposing Release was issued on October 18, 2002. The comment period ended on November 25, 2002. No final rule has yet been issued.

Summary — The proposed rule provides, in relevant part, that:

> [N]o officer or director of an issuer, or any other person acting under the direction thereof, shall di-

rectly or indirectly take any action to fraudulently influence, coerce, manipulate, or mislead any independent public or certified public accountant engaged in the performance of an audit or review of the financial statements of that issuer that are required to be filed with the Commission if that person knew or was unreasonable in not knowing that such action could, if successful, result in rendering such financial statements materially misleading.

Release 34-46685 at 21. The proposing release specifically identifies certain types of activities that may potentially violate the prohibition in the Act, including, directly or indirectly: (i) offering or paying bribes or other financial incentives, including offering future employment or contracts for non-audit services; (ii) providing an auditor with inaccurate or misleading legal analysis; (iii) threatening to cancel or canceling existing non-audit or audit engagements if the auditor objects to the issuer's accounting; (iv) seeking to have a partner removed from the audit engagement because the partner objects to the issuer's accounting, (v) blackmailing; and (vi) making physical threats. Id. at 6.

Section 306(a) – Insider Trades During Pension Fund Blackout Periods

SOA – Section 306(a) of the Act prohibits any director or executive officer of an issuer to purchase, sell or otherwise acquire or transfer, directly or indirectly, any shares of the issuer during any pension plan blackout period with respect to such equity security, if the director or executive officer acquired the equity security in connection with his or her service or employment as a director or executive officer. Section 306(a) also requires the issuers to notify directors and executive officers and the Commission of a blackout period that could affect them.

Rulemaking Status – The SEC proposed so-called Regulation BTR on November 6, 2002. The comment period ended December 16, 2002. On January 22, 2003, the SEC issued the final Regulation BTR.

Summary – Regulation BTR (for "Blackout Trading Restrictions") generally restricts trading by executive officers and directors in the issuer's equities during pension fund blackout periods. Regulation BTR is intended to "facilitate compliance with the will of Congress . . . and to eliminate the inequities that may result when pension plan participants and beneficiaries are temporarily prevented from engaging in equity securities transactions through their plan accounts." Release No. 34-47225 at 1. Regulation BTR is explicitly patterned on the trading restrictions and grounds for liability established by Section 16 of the Exchange Act and the regulations promulgated pursuant to Section 16. Like the Section 16 regime, the specifics of Regulation BTR are complex. Briefly the key features are as follows:

- *General Restriction* – Reg BTR makes it unlawful for any director or executive officer of an issuer (including a foreign private issuer) of any equity security[6] (other than an exempt security), directly or indirectly, to purchase, sell or otherwise acquire or transfer any equity security of the issuer (other than an exempt security) during any blackout period with respect to such equity security, if such director or executive officer acquires or previously acquired such equity security in connection with his or her service or employment as a director or executive officer.

  · *"Acquired in Connection with Service or Employment"* – Reg BTR includes a detailed definition of what it means for an equity security to be acquired in connection with service or employment as a director or executive officer.[7] Critically, however, Reg BTR adopts a rebuttable presumption that any securities of the issuer acquired, sold or transferred during a blackout period were "acquired in connection with service as a director or executive officer." It is then up to the director or officer to establish, as a defense, that the securities were acquired other than in connection with the director or officer's service to the issuer. 17 CFR § 245.100(a).

  · *Blackout Period* – Reg BTR defines "blackout period" to mean any period of three consecutive business days during which the ability of not fewer than 50% of the participants or beneficiaries to transact in the Plan is temporarily suspended by the issuer or a fiduciary.[8] 17 CFR § 245.100(b).

- *Notice to Officers/Directors and the Commission* – Reg BTR includes a detailed procedure for providing notice to the issuer's officers and directors as follows:

  · New Rule 104 provides that the content of the notice specify (i) the length of the blackout period – using either the actual or expected beginning and ending dates of the blackout period, or the calendar week or weeks during which the blackout period is expected to begin and end; (ii) the reason or reasons for the blackout period; (iii) the transactions restricted during the blackout period and the class of equity securities subject to the blackout period; and (iv) a contact person for questions concerning the blackout period;[9]

  · The Commission has attempted to coordi-

nate the required timing of the notice under Reg BTR with the required notice to pension plan participants under Department of Labor ("DOL") regulations; accordingly, the required notice to directors and executive officers is considered timely if it is issued not later than five business days after the issuer receives notice from the pension plan administrator required by DOL rules;[10] and

· Rule 104 requires that the issuer also provide public disclosure of an impending blackout period by filing a Form 8-K with the Commission; as a general matter, the Form 8-K must be filed with the Commission within five business days of receipt by the issuer of the notice from the plan administrator as required under DOL regulations.

17 CFR § 245.104.

◆ *Exempt Transactions* – Reg BTR specifies several transactions that are exempted from the blackout trading restrictions. These exempt transactions include: (i) acquisitions of equity securities under dividend or interest reinvestment plans; (ii) purchases or sales of equity securities pursuant to a trading arrangement that satisfies the affirmative defense conditions of Exchange Act Rule 10b5-1(c);[11] (iii) increases or decreases in the number of equity securities held as a result of a stock split or stock dividend applying equally to all equity securities of that class; (iv) acquisitions or dispositions of equity securities pursuant to a domestic relations order; (v) the exercise of a derivative security without any influence from the director or officer as to the exercise or conversion of the derivative. 17 CFR § 245.102; see also Release No. 34-47225 at 11.

◆ *Private Right of Action* – When a director or officer of the issuer violates Section 306(a), the Act permits either the issuer or a security holder of the issuer on the issuer's behalf, to bring an action to recover the profit gained by the officer or director.[12] The release accompanying Reg BTR likens the actions to a private right of action under Section 16(b). In determining damages in such an action, the final release directs courts to focus on the "gain realized or loss avoided" during the blackout period. 17 CFR § 245.103; see also Release No. 34-47225 at 21. Accordingly, (i) for transactions involving a security that is listed and traded on a national exchange, the measure of damages in a private action "may be measured by comparing the difference between the amount paid or received for the equity security on the date of the transaction during the blackout period and the average market price of the equity security calculated over the first three trading days after the ending date of the blackout period; (ii) for transactions not described in the foregoing subparagraph, "profit (including any loss avoided) may be measured in a manner that is consistent with the objective of identifying the amount of any gain realized or loss avoided by a director or executive officer as a result of a violation of Reg BTR. 17 CFR §245.103(c)(1)-(2).

Effective Time – The restrictions on trading during pension fund blackout periods is effective January 26, 2003. Issuers must comply with the requirement to disclose blackout periods publicly on Form 8-K beginning March 31, 2003 and may provide the required disclosure before then on Form 10-Q or 10-QSB.

Section 307 – Rules of Professional Responsibility for Attorneys

SOA – Section 307 provides that within 180 days of enactment, the Commission must issue rules "setting forth minimum standards of professional conduct for attorneys appearing and practicing before the Commission in any way in the representation of issuers." SOA §307. The statute further provides that the rule must include a requirement that attorneys report "evidence of a material violation of securities law or breach of fiduciary duty or similar violation by the company or any agent thereof," to either the chief legal counsel or the chief executive officer of the company and, in the event the CLO or CEO does not "appropriately respond to the evidence," then, to the audit committee or other committee of independent directors. SOA § 307(1) and (2).

Rulemaking Status – The SEC issued proposed rules on November 21, 2002. The comment period ended December 18, 2002. On January 23, 2003, the SEC issued the final rule. The SEC has, however, issued a further proposed rule pursuant to Section 307 regarding whether or not attorneys practicing before the Commission should be required to effect a "noisy withdrawal" (and notify the Commission) under certain circumstances.

Summary – The final rule implements the "up the ladder" reporting requirement called for by Sarbanes-Oxley and, in addition, provides an alternative method of reporting evidence to a "qualified legal compliance committee." The Final rule also includes a safe-harbor from civil liability.

◆ *Reporting Procedure* — The final rule requires attorneys who practice before the Commission to report "evidence of" a material violation of the securities laws or a material breach of fiduciary duties. The report of such evidence must be made in one of the following two ways:

· *"Up the Ladder" Reporting* – The final rule requires attorneys who learn of evidence of a material violation of the securities laws or material breach of fiduciary duty to report the evidence to the Chief Legal Officer (CLO) or the Chief Executive Officer (CEO) of the company. If the reporting attorney does not receive an "appropriate response" within

a reasonable time from the CLO or the CEO, then the reporting attorney is obligated to report the evidence to the audit committee or, if the issuer does not have an audit committee, then to "another committee of independent directors," or, if the issuer does not have another committee of independent directors, then, the report must be made to the full board of directors. 17 CFR § 205.3(b); see also Release No. 33-8185 at 6-17.

· *Report to a Qualified Legal Compliance Committee* – As an alternative to the "up the ladder" reporting procedure, the rule allows issuers to establish a "qualified legal compliance committee" (QLCC) which would become responsible for receiving and investigating evidence of a material violation of the securities laws or material breach of fiduciary duty. 17 CFR § 205.3. The QLCC would also be responsible for determining whether the issuer has made an appropriate response to the reported evidence of a violation. 17 CFR § 205.3(c); see also Release No. 33-8185 at 17-20. Under the proposed rule, attorneys who do not receive an appropriate response within an appropriate period of time would have been required to report the evidence directly to the SEC. Under such a rule, the existence of a QLCC was a significant factor because the proposed rule had provided that the attorney may discharge its obligation to assess whether an appropriate response has been made by simply reporting the evidence to a QLCC. The reporting attorney would thereupon no longer be responsible for determining whether the issuer has made an "appropriate response" to the evidence and potentially reporting the matter to the Commission. As the rule presently stands, reporting to the QLCC removes some of the burden from the reporting attorney with regard to the investigated and reporting obligations of the rule.[13]

◆ *No Paper-Trail Requirement* – The final rule has dropped the requirement in the proposed rule that an "attorney reporting evidence of a material violation shall take steps reasonable under the circumstances to document the report and the response thereto and shall retain such documentation for a reasonable time." See Release No. 33-8185 at 22. Many commentators noted that this requirement could give rise, to a conflict of interest between attorney and client. Id. at 23.

◆ *Noisy Withdrawal* – The SEC has deferred a decision on the most controversial element of the proposed rule. The proposed rule had included a requirement that an outside attorney effect a "noisy withdrawal" from representing an issuer if the attorney: (i) has reported a material violation of the securities laws or a material breach of fiduciary duty to the CEO or CLO and to the audit committee, other committee of majority outside directors or the full board; (ii) has not received an "appropriate response" in a reasonable time; and (iii) "a material violation is ongoing or is about to occur and is likely to result in substantial injury to the financial interest or property of the issuer or of investors." Release No. 33-8105 at 70. The attorney would also be required, within one business day, to inform the Commission that the attorney has withdrawn for "professional considerations." Id.

· *Rulemaking Status* – The SEC has voted to extend for 60 days (to February 24, 2003) the comment period on the proposed "noisy withdrawal" requirement. Release No. 33-8186. The SEC has proposed an alternative to the "noisy withdrawal" requirement whereby, upon reporting evidence of a material violation "up the ladder" or to the QLCC, and not receiving an appropriate and timely response, the attorney would be required to either: (i) notify the issuer that the attorney is withdrawing from the representation; or (ii) notify the issuer that the attorney has not received an appropriate and timely response to the evidence of the material violation. Upon receiving either notice from an attorney, the issuer, rather than the attorney, would be required to disclose this development by filing the information on a Form 8-K. Id. at 10-13.

◆ *Permissive Disclosure of Confidences* – The final rule permits, but does not require, counsel to an issuer to disclose confidential information to the Commission to the extent the attorney reasonably believes disclosure necessary to (i) prevent a material violation that is likely to cause substantial financial injury; (ii) prevent the issuer from suborning perjury or from violating the false statement section of the criminal code (18 USC § 1001) in a Commission investigation or administrative proceeding; or (iii) to rectify the consequences of a material violation by the issuer that caused or may cause substantial injury.

◆ *No Private Right of Action* – The final rule promulgated pursuant to Section 307 includes an important safe-harbor against personal liability for non-compliant attorneys. Section 307 threatened to expand significantly the grounds for liability against attorneys so as to include all shareholders suffering losses as a result of securities fraud or a breach of fiduciary duty; indeed, Section 307 threatened to permit a cause of action against attorneys advising corporate issuers where the corporate issuer's directors (and possibly officers) could be exculpated from liability. Compare Del. Gen. Corp. L. § 102(b)(7) with SOA § 307. The Commission has largely removed this risk by providing in the final rule that "the rules do not create a private cause of action and that authority to enforce compliance with the rules is vested exclusively with the Commission."

Effective Time – The new Part 205 takes effect 180 days after publication in the *Federal Register*.

Section 401 – Disclosures in Periodic Reports

Section 401(a) – Disclosure of Off-Balance Sheet Transactions

SOA – Section 401(a) of Sarbanes-Oxley requires the Commission to issue final rules providing that each quarterly and annual report shall disclose all material off-balance sheet transactions, arrangements, obligations (including contingent obligations) and other relationships of the issuer with unconsolidated entities or other persons, that may have a material effect on the financial condition of the issuer.

Rulemaking Status – The SEC issued the proposed rule on November 4, 2002. The comment period ended December 9, 2002. On January 27, 2003, the SEC issued the final rule pursuant to Section 401(a).

Summary – The final rules require each registrant to include in their MD&A disclosure[14] a separate, titled section concerning the registrant's "off-balance sheet arrangements." Generally, the new rules "clarify disclosures that registrants must make with regard to off-balance sheet arrangements, require registrants to set apart disclosure relating to off-balance sheet arrangements in a designated section of MD&A and (except in the case of small business issuers) require tabular disclosure of aggregate contractual obligations." Release No. 33-8182 at 4.

- *Off-balance Sheet Arrangements* – The final rules define off-balance sheet arrangements to include any contractual arrangement to which an unconsolidated entity[15] is a party, under which the registrant has: (i) any obligation under certain guarantee contracts;[16] (ii) an interest retained by the registrant in assets transferred to an unconsolidated entity as credit support for that entity;[17] (iii) any obligation under certain derivative contracts; (iv) any obligation, including a contingent obligation, arising out of a material variable interest,[18] held by the registrant in an unconsolidated entity, where such entity provides financial, liquidity, market risk or credit risk support to, or engages in leasing or hedging with, the registrant. 17 CFR §228.303(c)(3).

- *Disclosure Threshold* – The proposed rules had established a low threshold for the disclosure of off-balance sheet transactions. Specifically, the proposed rule would have required disclosure of all "off-balance sheet arrangements" unless "the likelihood of either the occurrence of an event implicating an off-balance sheet arrangement, or the materiality of its effect, is remote." Release No. 33-8182 at 7. The final rule has retreated from this standard and, instead, requires disclosure of off-balance sheet arrangements that "have or are reasonably likely to have, a current or future effect on the issuer's financial condition . . . that is material to investors." 17 CFR §228.303(a)(1); Release No. 33-8182 at 7.[19]

- *Required Table of Contractual Commitments* – The final rules require issuers to disclose in tabular form the amounts of payments due, aggregated by category of contractual obligation, for specified time periods, with regard to the following categories of commitments: (i) long-term debt; (ii) capital lease obligations; (iii) operating leases; (iv) purchase obligations; and (v) other long-term liabilities. Small business issuers[20] are not required to make such disclosures in tabular form.

Effective Time – Registrants must comply with the final rules' off-balance sheet arrangements disclosure requirements in registration statements, annual reports and proxy statements that are required to include financial statements and that are filed by June 15, 2003. The final rules require issuers to include the tabular report of contractual commitments in registration statements, annual reports and proxy statements that are required to include financial statements and that are filed on or after December 31, 2003.

Section 401(b) – Use of *Pro Forma* Figures

SOA – Section 401 of Sarbanes-Oxley directs the Commission to adopt rules which provide that *pro forma* financial information[21] included in any disclosure shall be prepared in such a way that: (i) the *pro forma* financial information does not contain any material untrue statement of fact or omission; and (ii) the *pro forma* financial information is reconciled with the financial results of the issuer as calculated in accordance with GAAP.

Rulemaking Status – The SEC proposed Regulation G on November 5, 2002. The comment period ended December 13, 2002. On January 22, 2003, the SEC issued the final rule.

Summary – Regulation G applies whenever an issuer publicly discloses or releases material information that includes a non-GAAP measure of financial results.

- *Non-GAAP Financial Measures* – The final rule defines a "non-GAAP financial measure" as "a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that excludes amounts . . . that are included in the most directly comparable measure calculated and presented in accordance with GAAP . . . or includes amounts . . . that are excluded from the most directly comparable measure" under GAAP. 17 CFR §244.101(a)(1); see also Release No. 33-8176 at 8-9. A widely used example of such non-GAAP financial measures is EBITDA, which is often intended to substitute for GAAP earnings.[22] Non-GAAP financial measures do not include financial measures that do not have an analogous GAAP measure and do not include ratios

and other statistical measures that are calculated in accordance with GAAP. 17 CFR §244.101(a)(2).

· *Foreign Private Issuers* – Regulation G applies to many foreign private issuers.[23] However, with respect to foreign private issuers whose primary financial statements are prepared in accordance with non-GAAP standards, those issuers must conduct reconciliations between any reported financial results that are not prepared in accordance with the non-GAAP standard, on the one hand, and the appropriate non-GAAP standard, on the other hand. 17 CFR § 244.101(b).

· *Pro Forma* Merger Calculations – The final rules provide an exception for non-GAAP financial measures contained in disclosures relating to business combinations. 17 CFR § 229.10(e)(6).

◆ *General Anti-fraud Provision* – Reg G provides generally that an issuer shall not make public a non-GAAP financial measure that, taken together with the information accompanying that measure, contains an untrue statement of material fact or omits to state a material fact.[24] 17 CFR § 244.100(b).

◆ *Reconciliation Requirement* – Regulation G provides further that when an issuer discloses material financial information that includes a non-GAAP financial measure, the issuer is required to provide the following information as part of the release or disclosure containing the non-GAAP measure: (1) a presentation of the most-directly comparable financial measure calculated and presented in accordance with GAAP; and (2) a quantitative reconciliation of the differences between the *pro forma* number and the most directly comparable GAAP financial measure. 17 CFR §244.100(a); see also Release No. 33-8176 at 12-13.[25]

· *"Most Directly Comparable Financial Measure"* – Key to Regulation G is the concept of the "most directly comparable financial measure." Yet, the final rule and the release do not define or attempt to define the term.[26] This is an important oversight. It may be unclear what is the "most directly comparable financial measure." What, for example, is "most directly comparable" to EBITDA? Net income or cash flow from operations?

◆ *Submission of Earnings Announcements on Form 8-K* – Reg G further requires issuers "to furnish to the Commission a Form 8-K within five business days of any public announcement or release disclosing material non-public information regarding a registrant's results of operations or financial condition for an annual or quarterly fiscal period that has ended." Form 8-K, Item 12; see also Release No. 8176 at 21.[27] Reg G, as proposed, would have required the 8-K to be "filed" with the Commission. The final Reg G requires only that earnings and other financial information be "furnished to the Commission" on Form 8-K and not technically "filed" with the Commission.[28] Id.

◆ *No Effect on Antifraud Liability* – The final rule explicitly provides that the compliance or non-compliance with Reg G shall not affect, one way or the other, any person's liability under Section 10(b) of the Exchange Act or Rule 10b-5. 17 CFR §244.102.

Effective Time – Reg G will apply to all subject disclosures made as of March 28, 2003.

Section 403 – Disclosure of Transactions Involving Management and Principal Stockholders

SOA – Section 403 of the Act amends Section 16 of the Exchange Act to require Forms 3, 4, and 5 to be filed under Section 16 on an accelerated basis. Section 16, as amended by Sarbanes-Oxley, provides that upon becoming a 10% beneficial owner, director or officer of an issuer, the requisite filing must made within 10 days thereafter, and then, upon any purchase or sale of the securities of the issuer or execution of any securities-based swap agreement, the requisite filings must be made before the end of the second business day following the transaction. The Act also requires that, within one year of enactment (July 30, 2003), Forms 3, 4 and 5 must be filed electronically.

Accelerated Filing of Forms 4 and 5

Rulemaking Status – The final rule was issued on August 27, 2002.

Summary – The final rule amends Rule 16a-3 and Rule 16a-6 and Forms 3, 4 and 5 under the Exchange Act. Previously, Section 16(a) had permitted changes in ownership of an issuer's securities by officers, directors or 10% shareholders to be disclosed within 10 days after the end of the month in which the trade took place. Section 403(a) and the final rules now require such changes in ownership to be disclosed on Form 4 within 2 business days of the trade.

Transactions Exempt from T+2 Requirement – The final rules provide that the following two categories of transactions not subject to the 2 day reporting requirement: (i) trades made pursuant to a 10b5-1 trading plan where the reporting person does not select the date of the transaction; and (ii) discretionary trades made pursuant to an employee benefit plan where the reporting person does not select the date of execution. Instead these trades must be reported on Form 4 by the end of the second day following either (i) the date that notice of the trade is provided to the reporting person or (ii) the third day following the date that the trade has taken place.

Transactions Between Officers/Directors and Issuer – Under the final rule, transactions between an officer or director and the issuer (such as options exercises), previously reportable on Form 5 by the end of the year, now must be reported on Form 4 by the end of the second business day following the trade.

Electronic Filing of Forms 3, 4 and 5 – Proposed Rule

Rulemaking Status – The proposed rule was released December 20, 2002. Comments must be submitted on or before February 10, 2003. No final rule has yet been released.

Summary – The proposed rule would amend Regulation S-T, Rule 16a-3(k) and Forms 3, 4 and 5 to require the electronic filing of Section 16 forms on EDGAR by July 30, 2003 and also require the electronic posting of Forms 3, 4 and 5 on issuer websites. With regard to the latter disclosure, the proposed rule would require issuers to post all Form 3, 4, and 5 filings by the end of the day of filing with the Commission. An issuer could meet this requirement by providing access to a third-party website displaying the filed forms. Access to the forms on a third party site must, among other things, be free of charge to any investor and must be direct from the issuer's website.[29]

Effective Date – The accelerated filing requirements became effective on August 29, 2002. No effective date has been set by the Commission with respect to the electronic reporting requirements. However, the Act requires compliance by July 30, 2003 and the Commission has urged compliance pending release of the final rules.

Section 406 – Code of Ethics for Senior Financial Officers

SOA – Sarbanes-Oxley Section 406 requires the Commission to issue rules requiring each issuer to disclose whether it has adopted a code of ethics for its senior financial officers, including its chief executive officer and controller (or individuals performing similar functions). SOA at § 406(a). The Act also requires that the SEC amend its disclosure regime to require that issuers promptly disclose on form 8-K or via the Internet any change in or waiver of the code of ethics. SOA at § 406(b).

Rulemaking Status – On October 22, 2002, the SEC issued the proposed addition of Parts 228, 229 and 249 to chapter 17 of the Code of Federal Regulations. The comment period ended November 29, 2002 and the final rule was issued on January 23, 2003.[30]

Summary – The final rule requires each issuer to disclose whether or not it has adopted a code of ethics for senior financial officers, including the issuer's chief financial officer and controller. In a departure from the requirements of the Act, the final rule also requires each issuer to disclose whether it has adopted a code of ethics that applies to the issuer's chief executive officer as well as the chief financial officer. 17 CFR §229.406(a); see also Release No. 34-47235.

- *Code of Ethics* – Each code of ethics must be reasonably designed to deter wrongdoing and to promote: (i) honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships; (ii) full, fair, accurate, timely and understandable disclosure; (iii) compliance with applicable governmental laws, rules and regulations; (iv) the prompt internal reporting to an appropriate person or persons identified in the code of ethics of violations of the code; and (v) accountability for adherence to the code. The non-specific nature of these requirements was evidently deliberate. In the issuing release, the Commission specifically noted, for example, that "[w]e continue to believe that ethics codes do, and should, vary from company to company and that decisions as to the specific provisions of the code, compliance procedures and disciplinary measures for ethical breaches are best left to the company." 17 CFR §229.406(b); Release No. 34-47235 at 33.

- *Required Public Disclosure of Code* – The final rule requires companies to disclose their code(s) of ethics applicable to senior financial officers and to the chief executive officer. The Commission has provided issuers with different options for disclosing the contents of their code(s) of ethics. An issuer may file its code of ethics as an exhibit to its annual report. Alternatively, an issuer may post its code of ethics on its website and disclose in the annual report that it has done so. Thirdly, an issuer may commit in its annual report to provide free of charge printed copies of its code of ethics to anyone requesting a copy. 17 CFR §229.406(c); see also Release No. 34-47235 at 34.

- *Disclosure of Changes/Waivers of Code* – The final rule adds an item to list of events triggering an obligation to make prompt disclosure on Form 8-K. The new Item 12, requires disclosure of: (i) any amendments to the issuer's code of ethics that applies to a senior financial officer or to the chief executive officer; and (ii) any waiver, including an implicit waiver, from any provision of the code of ethics. 17 CFR §229.406(d). "Waiver" is defined as "the approval by the company of a material departure from a provision of the code of ethics." Release No. 34-47235 at 37. "Implicit waiver" is defined as the issuer's failure to "take any action within a reasonable period of time regarding a material departure from a provision of the code of ethics that has been made known to an executive officer." Id. As an alternative to filing this information on a Form 8-K, an issuer may disclose amendments to or waivers from the code of ethics on its website.

Effective Time – Companies must comply with the code of

ethics disclosure and amendment/waiver disclosure requirements in their annual reports for fiscal years ending on or after July 15, 2003.

Section 407 – Disclosure of Audit Committee Financial Expert

SOA – Section 407 of Sarbanes-Oxley requires the Commission to issue rules requiring each issuer to disclose whether or not at least one member of its audit committee is a "financial expert" as defined by the Commission. SOA at § 407(a). The Act further directs the Commission, in fashioning a definition of "financial expert" to consider whether, through education or experience, a person has knowledge of GAAP, experience in preparing financial statements and experience with accounting for estimates, accruals or reserves. Id. at 407(b).

Rulemaking Status – On October 22, 2002, the SEC issued the proposed addition of Parts 228, 229 and 249 to chapter 17 of the Code of Federal Regulations. The comment period ended November 29, 2002 and the final rule was released on January 23, 2003.[31]

Summary – The rule requires each issuer to disclose whether it has at least one financial expert serving on its audit committee. In response to numerous comments, the Commission has departed from the term "financial expert" in the final rule and has adopted the term "audit committee financial expert" instead. Compare SOA at § 407(a) with Release No. 33-8177 at 6. The change in terminology is meant to reflect the emphasis in Sarbanes-Oxley on accounting/auditing matters and not on matters of valuation, capital structure, financial risk management and other strictly financial matters. Release No. 33-8177 at 6. The final rule includes specific a definition of "audit committee financial expert."

- *Audit Committee Financial Expert* – The final rule provides that anyone designated as an Audit Committee Financial Expert must have the following attributes: (i) an understanding of GAAP;[32] (ii) the ability to assess the general application of GAAP in connection with the accounting for estimates, accruals and reserves;[33] (iii) experience preparing, auditing, analyzing or evaluating financial statements or experience in supervising persons engaged in these activities;[34] (iv) an understanding of internal controls and procedures for financial reporting; and (v) an understanding or audit committee functions. Release No. 33-8177 at 15.

- *Disclosure Requirement* – The final rule requires issuers to disclose either that (i) it has at least one Audit Committee Financial Expert serving on its audit committee; or (ii) it does not have an Audit Committee Financial Expert serving on its audit committee. If the issuer does not have an expert serving on its audit committee, it must explain why it does not. Release No. 33-8177 at 8. If the issuer discloses that it has an at least one expert serving on its audit committee, it must disclose the expert's name. This disclosure must be made in the issuer's annual report or in its annual proxy statement provided the latter is filed within 120 days after the end of the fiscal year. Id. at 29.

- *Safe Harbor* – Many of the comments submitted in response to the proposed rule regarding "financial experts" focused on the risk that such a financial expert might be exposed to an increased risk of liability as a result of their designated expertise. 17 CFR § 229.401(h)(4). For example, under Section 11 of the Securities Act, outside directors of an issuer ordinarily are not subject to liability for so-called "expertised" portions of a registration statement, including the issuer's audited financial statements.[35] One question is whether the "financial expert" on the audit committee may, by virtue of the designation, become liable for expertised as well as non-expertised portions of a registration statement in a Section 11 action or whether the financial expert must meet a higher standard to establish a due diligence defense under Section 11. Another question is whether such an expert has heightened fiduciary duties under state corporation law[36] or is more likely, a practical matter, to be shown to have acted with scienter or actionable recklessness under Section 10(b) of the Exchange Act and Rule 10b-5. The Commission has attempted to address these concerns by providing a limited safe-harbor for all Audit Committee Financial Experts. In particular, the limited safe harbor clarifies that:

  · A person who is determined to be an "audit committee financial expert" will not be deemed an "expert" for any purpose, including without limitation for purposes of liability under Section 11 of the Securities Act 17 CFR § 229.401 (h)(4)(i). In particular, the safe harbor provides that any portion of a registration statement reviewed by an Audit Committee Financial Expert is not thereby "expertised." Id.

  · The final rule provides further that designation of a person as an Audit Committee Financial Expert does not impose any duties, obligations or liability that are greater than the duties, obligations and liability imposed on such person as a member of the audit committee and the board of directors;[37] and

  · The designation of a person as an Audit Committee Financial Expert does not affect the duties of other members of the audit committee or of the board of directors.

  17 CFR § 229.401(h)(4); Release No. 33-8177 at 27.

- *Selection of Audit Committee Financial Expert* – the

final rule provides that the issuer's board of directors is responsible for determining whether an individual qualifies as an Audit Committee Financial Expert within the meaning of the final rule. 17 CFR § 229.401(h).

Effective Date – Companies, other than small business, must comply with the Audit Committee Financial Expert disclosure requirements promulgated pursuant to Section 407 in their annual reports for fiscal years ending on or after July 15, 2003. Small business issuers must comply with the disclosure requirements in their annual reports for fiscal years ending on or after December 15, 2003.[38]

Section 802 – Preservation of Audit Records

SOA – Section 802 of the Act directs the Commission to adopt regulations regarding the retention of relevant audit and accounting records, such as work papers and documents that form the basis of an audit or review or documents that are created, sent, or received in connection with an audit or review and contain conclusions, opinions, analyses, or financial data relating to such an audit or review.

Rulemaking Status – The SEC proposed on November 21, 2002. The comment period ended December 27, 2002. On January 24, 2003, the SEC issued the final rule.

Summary – The final rule requires that an auditor retain for a period of seven years records relevant to the audit or review and that meet two criteria: (i) the materials are created, sent or received in connection with the audit or review; and (ii) the materials contain conclusions, opinions, analyses, or financial data related to the audit or review. Release No. 33-8180 at 4-5. The release clarifies that materials relating to an audit shall be retained "whether they support the auditor's final conclusions regarding the audit or review, or contain information or data, relating to a significant matter, that is inconsistent with the auditor's final conclusions regarding that matter or the audit or review. See Release No. 33-8180 at 33 (17 C.F.R. § 210.2-06(c)).

Effective Time – Auditors must comply with the record retention requirements for audits and reviews completed on or after October 31, 2003.

* * *

The rules promulgated pursuant to the Act attempt to effect a dramatic change in corporate governance and disclosure practices. As the Commission notes in one final release: "The Sarbanes-Oxley Act clearly was intended to enhance corporate responsibility by effecting significant change; its purpose was not to perpetuate the status quo." Release No. 33-8177. While it remains a question how significantly the Act and the rules promulgated pursuant to the act will enhance corporate responsibility, there is no question that the new governance and disclosure regime will have lasting effect on corporate America for years to come.

* Peter L. Welsh, Ropes & Gray, Boston, Massachusetts. Co-Chair, Corporate Governance Subcommittee. The views expressed in this article do not necessarily represent the views of Ropes & Gray or its clients. The statements contained herein are not intended to constitute and do not constitute legal advice. This article was originally published at www.fed-soc.org on February 4, 2003.

Footnotes

[1] Generally speaking, regulation S-X governs the financial information contained in the annual and quarterly reports of issuers. Regulation S-K generally governs the non-financial portions of annual and quarterly reports of an issuer.

[2] Citations herein to page numbers in the relevant SEC releases refer to the page number of the printed version of the releases downloaded from the SEC's website at www.sec.gov.

[3] The final rules provide an exception for *de minimus* and inadvertent violations of the requirement that the audit committee approve. In particular, pre-approval is not required for "(1) all [non-audit] services that do not aggregate more than five percent of total revenues paid by the audit client to its accountant in a particular year; (2) [the non-audit services] were not recognized as non-audit services at the time of the engagement; and (3) are promptly brought to the attention of the audit committee and are approved by the audit committee prior to the completion of the audit." 17 CFR § 210.2-01(c)(7)(i)(c).

[4] Judge Friendly held, for example, that "[w]e think the [district court] judge was right in refusing to make the accountants' testimony so nearly a complete defense. The critical test according to the charge was the same as that which the accountants testified was critical. We do not think the jury was also required to accept the accountants' evaluation whether a given fact was material to overall fair presentation, at least not when the accountants' testimony was not based on specific rules or prohibitions to which they could point, but only on the need for the auditor to make an honest judgment and their conclusion that nothing in the financial statements themselves negated the conclusion that an honest judgment had been made." Simon, 425 F.2d at 806.

[5] The Commission explained, in the Final Release that a "fair presentation" of an issuer's financial condition, results of operations and cash flows "encompasses the selection of appropriate accounting policies, proper application of appropriate accounting policies, disclosure of financial information that is informative and reasonably reflects the underlying transactions and events and the inclusion of any additional disclosure necessary to provide investors with a materially accurate and complete picture of an issuer's financial condition, results of operations and cash flows." Release No. 33-8124 at 7.

[6] "Equity security" under Reg BTR includes any equity security or derivative security relating to an issuer, whether or not issued by that issuer. Derivative security has the same meaning as in Exchange Act Rule 16a(1)-c and the release accompanying the final rule provides that the term "derivative security" is to be interpreted in a manner that is consistent with how the term is interpreted under Section 16.

[7] Reg BTR provides, for example, that an equity security is acquired in connection with service or employment as a director or executive officer where: (i) acquired at a time when the officer or director was a participant in a plan relating to options, warrants or rights, pension, retirement or deferred compensation or bonus, incentive or profit-sharing (whether or not set forth in any formal plan document), including a compensatory plan, contract, authorization or arrangement with a parent, subsidiary or affiliate; (ii) the equity security was acquired as a direct or indirect inducement to service or employment as a director or executive officer; and (iii) where the equity security was received as a result of a business combination in respect of an equity security of an entity involved in the business combination that he or she had acquired in connection with service or employment as a director or executive officer of that entity.

[8] The release accompanying the final rule notes that the Commission "remains concerned that the problems [Sarbanes-Oxley] is intended to address

may not be limited to blackout periods that last longer than three consecutive business days . . . We will continue to consider whether these issues, to attempt to ascertain whether blackout periods of three business days or less are or may become a concern and to talk to the Department of Labor about possible solutions." Release No. 34-47225 at 13.

[9] The option either to notice the specific expected begin/end dates or to notice the week(s) during which the begin/end dates are expected to occur is intended to deal with the uncertainty involved in managing the timing and length of the blackout period. Reg BTR requires, however, that when the notice specifies only the week(s) during which the blackout period is expected to occur, directors and officers be provided access to real time information during the noticed week(s) regarding the actual beginning date and ending date as they occur. 17 CFR § 245.104(b)(1)(iv). Where the notice specifies the anticipated beginning and ending dates, it must be updated with a subsequent notice if, in the event, the actual begin and end dates differ from the notice begin and end dates as previously noticed. The updated notice is required to be provided as soon as reasonably practicable. Release No. 34-47225 at 24.

[10] The final release specifically notes that, "an issuer's failure to provide notice [to its directors or executive officers] will not preclude a Commission enforcement action for a violation of Section 306(a)(1) of the Act or a private action to recover profits under Section 306(a)(2)." The failure to provide notice may also lead to an enforcement action against the issuer, "whether or not a director or executive officer subsequently violates the Section 306(a) trading prohibition." Release No. 34-47225 at 23.

[11] The release accompanying Reg BTR clarifies that transactions pursuant to a trading arrangement that satisfies the conditions of 10b5-1(c) are exempt from Reg BTR as long as the as the trading plan is not entered into or modified during a blackout period or at a time when the director or officer is aware of the approximate beginning or ending of the blackout period. Release No. 34-47225 at 10.

[12] A violation of Section 306(a) of the Act is a violation of the Exchange Act and, as such, "subject to all resulting sanctions, including Commission enforcement action." Release No. 34-47225 at 20.

[13] The final rule also provides that an attorney engaged by the QLCC to investigate evidence of a possible material violation "shall not have any obligation to report evidence of a material violation under [the final rule]." 17 CFR §205.3(b)(7). An attorney retained by the issuer and reporting to the CLO, in comparison, is relieved of his or her obligation to report "up the ladder" only where the investigating attorney and the CLO reasonably believe that no material violation has occurred or where the CLO reports the possible material violation "up the ladder." 17 CFR §205.3(b)(6)(B).

[14] The Commission has consistently stressed the importance of MD&A to the overall quality of disclosure. The final release is no exception: "The Commission has long recognized the need for a narrative explanation of financial statements and accompanying footnotes and has developed MD&A over the years to fulfill this need. The disclosure in MD&A is of paramount importance in increasing the transparency of a company's financial performance and providing investors with the disclosure necessary to evaluate a company and make informed investment decisions." Release No. 33-8182 at 3.

[15] Consolidation depends principally on the level of control held over the entity in question. Under current rules, control of greater than 50% of the voting securities of an entity gives rise to a presumption in favor of consolidation. See SFAS 94 (1986). Special purpose entities presumptively should be consolidated if unaffiliated entities have invested less than 3% of the entity's total capital. See EITF 90-15 (Describing the 3% requirement but noting that "the SEC staff believes that a greater investment may be necessary depending on the facts and circumstances, including the credit risk associated with the lessee and the market risk factors associated with the leased property."); see also Excerpts from Speeches by the Staff of the Office of the Chief Accountant Through December 6, 2001 (Washington, DC: Securities and Exchange Commission 2001). In addition, FASB is currently considering increasing the minimum requirement for unaffiliated capital contributions from the current 3% to 10%. See Release No. 33-8144, n.37 (citing FASB Exposure Draft, Proposed Interpretation, Consolidation of Certain Special-Purpose Entities (June 2002).

[16] The release accompanying the final rule defines "guarantee" by reference to FASB Interpretation No. 45. Such guarantees include (i) contracts that contingently require the guarantor to make payments to the guaranteed party based on changes in the "underlying;" (ii) contracts that contingently require the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement; (iii) indemnification agreements; and (iv) indirect guarantees of indebtedness whereby one entity is obligated to transfer funds to another entity such that the funds thereupon become available to the second party's creditors. Release No. 33-8182 at 12.

[17] This refers to a form of credit support whereby the issuer would retain an interest in the collateral securing obligations of the unconsolidated entity. For example, an entity transferring accounts receivable to an unconsolidated entity may retain an ownership interest in the last-dollar receivables such that, if a percentage of the pledged receivables are not ultimately collectable, the guarantor bears the costs of such losses. See Release No. 33-8182 at 13.

[18] The release accompanying the final rule notes that "variable interest" is defined as a "contractual, ownership, or other pecuniary interest in an entity that changes with the entity's net asset value." Release No. 33-8182 at 13 (citing FASB Interpretation 46).

[19] In assessing whether an "off-balance sheet obligation" is reasonably likely to have a material effect on an issuer's financial condition, the release accompanying the final rule directs management to proceed as follows: First, identify all off-balance sheet arrangements. Second, assess the likelihood of the occurrence of any known trend, demand, commitment, event or uncertainty that could affect an off-balance sheet arrangement. If management cannot determine that any such occurrence is not "reasonably likely," then management is directed to assess the significance of the impact of any such occurrence assuming it comes to fruition. Release No. 33-8182 at 14.

[20] Defined as any entity that: (i) has revenues of less than $25,000,000; (ii) is a U.S. or Canadian issuer; (iii) is not an investment company; and (iv) if the entity is a majority-owned subsidiary, its parent also separately qualifies as a small business issuer. Release No. 33-8182 at n. 115 (citing 17 CFRS 228.10).

[21] "*Pro forma* financial information" refers to financial results that are prepared and presented for analytic purposes in a way that does not comply with GAAP. One such *pro forma* measure is operating earnings. The term "operating earnings" typically refers to earnings adjusted to remove non-recurring gains or, more often, charges. See, e.g. Jonathan Weil, "What's the P/E Ratio? Well, Depends on What is Meant by Earnings. Terms Like 'Operating,' 'Core,' 'Pro Forma' Catch Fire, Leave Investors Muddled: Earnings Before Bad Stuff," Wall Street Journal, A1 (August 21, 2001).

[22] Relying on EBITDA, rather than GAAP earnings or net income, for a particular reporting period may be economically inappropriate. See e.g., Benjamin Graham and David Dodd, Security Analysis p. 387 (New York: McGraw Hill 1932)("The argument is often made that depreciation charges may properly be ignored because they are mere bookkeeping entries and do not represent a real outlay of cash. This is a highly inaccurate statement of the case. Depreciation is not a mere bookkeeping conception because for the most part, it registers an actual diminution of capital values, for which adequate provision must be made if creditors or owners are to avoid deceiving themselves. Moreover, in the majority of cases, the depreciation charges are consumed or offset over a period of time by even larger cash expenditures made for replacements or extensions.")

[23] See 17 CFRS 230.405 (defining "foreign private issuer").

[24] One example of a *pro forma* disclosure that the Commission regarded as materially misleading involved calculating "operating" or "core" earnings by excluding a non-recurring charge while including a non-recurring gain without disclosing that fact in the earnings release. See, e.g., In the Matter of Trump Hotels & Casino, Inc., Release No. 34-45287 (Jan. 16, 2002). Along similar lines the Association of Investment Management Research, in a comment letter to the Commission, cautioned that *pro forma* disclosures could be misleading if the method used to prepare the *pro forma* numbers changes from reporting period to reporting period. See Release No. 33-8176 at n.23.

[25] If the *pro forma* information is provided orally, then the issuer may provide the reconciliation information by both (i) posting the infor-

mation on the issuer's web site; and (ii) disclosing the location and availability of the required accompanying information during the oral presentation. Id. at 13. If the *pro forma* information is forward-looking, the issuer must prepare a schedule or other presentation detailing the differences between the forward looking *pro forma* information and the most directly comparable GAAP measure. Id.

[26] The release accompanying the final rule states the following in this regard:

> Examples of financial measures calculated and presented in accordance with GAAP would include, but not be limited to, earnings or cash flows as reported in the GAAP financial statements. We believe that it is most appropriate to provide registrants with the flexibility to best make the determination as to which is the "most directly comparable financial measure calculated and presented in accordance with GAAP." We, therefore, do not believe that it is appropriate to provide a specific definition of that term. As general guidance, however, we note that our staff has been, and continues to be, of the view that (1) non-GAAP financial measures that measure cash or "funds" generated from operations (liquidity) should be balanced with disclosure of amounts from the statement of cash flows (cash flows from operating, investing and financing activities); and (2) non-GAAP financial measures that depict performance should be balanced with net income, or income from continuing operations, taken from the statement of operations.
>
> Release No. 33-8176 at n. 26.

[27] The requirement applies to each piece of financial information and not each disclosure of specific financial information so that a separate 8-K filing is not necessary for each announcement or release. A partial exception involves oral presentations of financial results. A separate 8-K is not necessary after an oral presentation of financial results provided that the oral presentation is preceded within previous 48 hours by a release or announcement that triggers the filing requirement and that (i) the presentation is broadly accessible; (ii) the financial information is provided on the issuer's web site; and (iii) the presentation was widely announced.

[28] The distinction between information furnished to the Commission and information filed with the Commission is generally and briefly as follows:

- Information "furnished to the Commission" is not subject to Section 18 of the Exchange Act;
- Information "furnished to the Commission" is not thereby incorporated by reference into a registration statement, proxy statement or other report unless specifically so incorporated; and
- Information that is "furnished to the Commission" is not subject to the requirements of Item 10 of Reg S-K or Item 10 of Reg S-B.

See Release 33-8176 at 23-24.

[29] The Proposed Rule would permit the issuer to link to a list of the filings are the actual filings themselves but not, for example, to the home page of the third-party if the person wishing to access the information must then conduct a search or navigate the third-party site in order to access the filings. Release No. 33-8170 at 4.

[30] The Commission has set forth similar requirements, implementing Section 406 of SOA, applicable to registered investment companies in a separate release. See Release No. IC-25914.

[31] The Commission has set forth similar requirements, implementing Section 407 of SOA, applicable to registered investment companies in a separate release. See Release No. IC-25914.

[32] The release accompanying the final rule provides that an Audit Committee Financial Expert must have "experience with financial statements that present accounting issues that are 'generally comparable' to those raised by the registrant's financial statements." Release 33-8177 at 20.

[33] The release accompanying the final rule clarifies that the expertise in accruals, estimates and reserves need be only of a general nature and need not be in the specific industry in which the issuer operates. Release No. 33-8177 at 18.

[34] The release clarifies that an Audit Committee Financial Expert need not have experience auditing companies or preparing audited financial statements. The Commission has broadened the requirement of Section 407 to include within the definition of Audit Committee Financial Expert "persons with experience performing extensive financial statement analysis of evaluation." Release No. 33-8177 at 19.

[35] Section 11 of the Securities Act provides for near strict liability of officers and directors of an issuer for misrepresentations contained in a registration statement subject to a defense of due diligence. See 15 USC § 77k (a)-(b). With respect to "expertised" portions of a registration statement, they are entitled to rely on the experts that prepared those portions of the registration statement provided that reliance is reasonable. See Id. at § 77k(b)(3)(A)-(B).

[36] In this regard, the release accompanying the final rule summarily states that "whether a person is, or is not, an audit committee financial expert does not alter his or her duties, obligations or liabilities. We believe this should be the case under federal and state law." Release No. 33-8177 at 28.

[37] Again, although the final rule provides that an "expert" designation does not impose any "additional duties, obligations and liability," an increased risk appears to the remain, at least as a practical matter, with regard to whether the designation of a person as an Audit Committee Financial Expert will thereby provide additional grounds for a strong inference of fraudulent intent or actionable recklessness in actions brought against the director under section 10(b) of the Exchange Act and Rule 10b-5.

[38] Comments to the proposed rule expressed concern that small businesses would have a more difficult time complying with the requirements of the final rule and would need additional time to enlist an Audit Committee Financial Expert. The Commission extended the time for compliance by small business issuers in view of this stated concern. Release No. 33-8177 at 18.

Criminal Law & Procedure

Project Safe Neighborhoods and Fair-Weather Federalism:

"Saving" the Second Amendment by Undermining the Tenth

*By Gene Healy**

Gun rights supporters in the Bush Administration and Congress are currently engaged in a dubious tradeoff: to save the Second Amendment, they've decided to undermine the Tenth. For two years running, Congress has appropriated funds for the centerpiece of the Bush crime-control agenda, Project Safe Neighborhoods (PSN), which is designed to ward off calls for additional gun control by ramping up enforcement of the gun laws already on the books.

PSN is a cautionary tale, a lesson in how a clever soundbite can lead to disastrous public policy. In this case the soundbite, heard often from candidate Bush on the Election 2000 campaign trail, is "we don't need any new gun control laws; we need to enforce the gun laws on the books." The public-policy disaster is PSN, a half a billion dollar effort to increase prosecutions for unlawful gun possession. Under PSN, gun crimes that would ordinarily be prosecuted at the state level—such as possession of a handgun by a felon or drug user—are increasingly channeled into the federal system. In addition to federalizing gun crimes, PSN acts as a prosecution-stimulus package, funding the placement of more than 700 new prosecutors (over 200 federal, 600 state) who will pursue gun law violations full-time.

What's wrong with enforcing the gun laws on the books? Several things, actually. First, most of the federal gun laws on the books ought not to be there in the first place. They're based on an overbroad view of Congress's authority under the Commerce Clause, and politicians given to invoking the Tenth Amendment on the campaign trail have no business flagrantly violating that amendment upon taking office. Second, the program will likely lead to a mindless "zero tolerance" policy for technical infractions of gun laws, by hiring prosecutors whose sole responsibility is to enforce a narrow slice of the criminal code. Third, PSN threatens to open a Pandora's box leading to further politicization and centralization of law enforcement priorities. Finally, even if one could sanction the constitutional violations and threats to the rule of law inherent in the program's structure, PSN does not even do what it promises—it does not reduce crime. If the G.O.P. wants to be the party of federalism, it needs to defund Project Safe Neighborhoods.

Criminal Law in the Constitutional Design

Speaking before the National Governors' Association shortly after taking office, President Bush declared:

> I'm going to make respect for federalism a priority in this administration. Respect for federalism begins with an understanding of its philosophy. The framers of the Constitution did not believe in an all-knowing, all-powerful federal government. They believed that our freedom is best preserved when power is dispersed. That is why they limited and enumerated the federal government's powers and reserved the remaining functions of government to the states.[1]

But PSN is utterly inconsistent with the "respect for federalism" that President Bush professes to hold. As he acknowledged in his remarks before the National Governors' Association, the only powers the federal government has are those that have been delegated to it by the people and enumerated in the Constitution. All other powers are, as the Tenth Amendment confirms, "reserved to the states respectively, or to the people."

In the area of criminal law, the Constitution provides the federal government with an exceedingly slender grant of authority over criminal matters. There are three specifically enumerated federal crimes—counterfeiting (Art. I, sec. 8, cl. 6); piracy (Art. I, sec. 8, cl. 10), and treason (Art. III, sec. 3, cl. 2)—and two general founts of federal criminal authority: Congress's power to punish "offenses against the law of nations" (Art. I, sec. 8, cl. 6) and its power to "make all laws which shall be necessary and proper for carrying into Execution the foregoing Powers" (Art. I, sec. 8, cl. 18).

The records of the Constitutional Convention debates indicate that this limited federal role was by design. At the Philadelphia Convention, discussion of criminal law issues focused almost exclusively on treason, piracy, counterfeiting, and offenses against the law of nations.[2] Federal criminal authority, like federal authority in general, was to be directed in the main toward affairs of state and international relations, as well as protecting the federal government and its interests. Ordinary criminal law, all agreed, was the province of the states. Alexander Hamilton argued that this would help the states maintain the affections of the citizenry, and resist encroachments by the federal government:

> There is one transcendent advantage belonging to the province of the State governments which alone suffices to place the matter in a clear and satisfactory light. I mean the ordinary administration of criminal and civil justice.[3]

An Affront to Federalism

Despite President Bush's professed "respect for federalism," his main crime-control initiative flies in the face of the Framers' constitutional vision. By employing federal gun-possession statutes that rest on an overbroad conception of the Commerce Power, PSN threatens to make the ordinary administration of criminal justice a federal responsibility.

More than one federal court has recognized the dangers inherent in federalizing prosecution of firearms offenses. In the 1999 case *U.S. v. Jones*, a three-judge panel in the federal district court for the Eastern District of Virginia, Richmond Division, assailed Project Exile, the prototype for President Bush's PSN. Like PSN, Project Exile was based on channeling firearms cases into the federal system. The *Jones* Court noted that this strategy represented "a substantial federal incursion into a sovereign state's area of authority and responsibility."[4] District judge Robert E. Payne struck a similar note in *U.S. v. Nathan* (1998): "[T]he federal government has embarked upon a major incursion into the sovereignty of Virginia." According to Judge Payne, the "risk of attenuating the Tenth Amendment" is present even in Project Exile in its current (voluntary) form. Moreover, "carried to its logical extreme [the argument for Exile] would make federal officers responsible for prosecuting all serious crimes in federal courts. Were that the case, we soon would have a federal police force with the attendant risk of the loss of liberty which that presents."[5]

Indeed, the Bush administration, with its embrace of the Exile model, seems bent on obliterating the distinction between what is properly local and properly national. One of the initiatives under the PSN umbrella is Project Sentry, which Attorney General Ashcroft describes as "a vital federal-state project dedicated to prosecuting gun crimes committed at our nation's schools and dedicated to protecting juveniles from gun crime."[6] Under Project Sentry, the Justice Department will provide every U.S. attorney's office with a new prosecutor to combat "school-related gun violence."[7] A more brazen affront to the spirit of *U.S. v. Lopez*, the historic 1995 Supreme Court decision striking down the Gun-Free School Zones Act, could hardly be imagined. In that case, Congress's attempt to make a federal crime out of gun possession in the vicinity of a school was held beyond the scope of the Commerce Power. The Court noted that, under the government's theory of the case, "It is difficult to perceive any limitation on federal power, even in areas such as criminal law enforcement or education where States historically have been sovereign."[8] But limitations on federal power and respect for the historic role of the states don't seem to be in vogue in the Bush Administration these days.[9]

Assembly-Line Justice

PSN also threatens to further erode prosecutorial discretion, and lead to a mindless, zero-tolerance approach towards marginal offenders. Unlike an ordinary prosecutor, whose bailiwick covers the gamut of criminal law, a Safe Neighborhoods prosecutor is limited to only one category of criminal charges. Where other prosecutors are able to shift their focus to other categories of crime once they've charged the most dangerous and deserving defendants in a given category of offense, Safe Neighborhoods prosecutors will have no other choice but to continue prosecuting violations of gun laws. Their incentive will be to keep focusing on the numbers—to continue producing indictments and convictions regardless of desert. This incentive threatens to result in assembly-line justice and overenforcement. The incentive structure that Safe Neighborhoods sets up will lead to the proliferation of "garbage" gun charges—technical violations of firearms statutes that no rational justice system would expend much effort on; worse, Safe Neighborhoods will likely result in federal and state governments' locking up firearms owners who do not deserve to be in jail.

Federal prosecutors already operate under an incentive structure that forces them to focus on the statistical "bottom line." Statistics on arrests and convictions are the Justice Department's bread and butter. As George Washington University Law School professor Jonathan Turley puts it, "In some ways, the Justice Department continues to operate under the body count approach in Vietnam… They feel a need to produce a body count to Congress to justify past appropriations and secure future increases."[10]

That "body count" mentality may help explain federal firearms prosecutions like the case of Katica Crippen, a Colorado woman who was convicted under the felon-in-possession statutes for posing nude on the Internet with a gun. Ms. Crippen was arrested when federal authorities came into the possession of seven nude photos of her in various poses, holding a firearm. Her prior drug convictions made her a felon-in-possession under federal law, and prosecutor James Allison brought the full force of the federal government down on her.

Judge Richard Matsch, who presided over the Timothy McVeigh trial, was outraged at the waste of federal resources and Allison's apparent lack of a sense of proportion. "How far is this policy of locking people up with guns going to go?" he demanded, "I want to know why this is a federal case. Who decided this is a federal crime?"

Indeed, it appears that Project Exile, the prototype for PSN, has already encouraged skewed priorities on the part of prosecutors. As federal judge Richard L. Williams commented of Richmond's Project Exile, "Ninety percent of these [Exile] defendants are probably no danger to society."[11]

More disturbing still is the prospect that PSN may result in some appalling miscarriages of justice. Even before PSN, overzealous federal prosecutors have taken extraordinarily punitive approaches toward marginal offenders.

One such case is worth studying in some detail: Michael Mahoney, a Tennessee businessman, is currently serving a 15-year term in federal prison as the result of a minor handgun offense. As the owner of the Hard Rack Pool Hall in Jackson, Tennessee, Mahoney had to make nightly cash deposits at his local bank. He carried a .22-caliber Derringer for personal protection while he did so. When Mahoney's pistol was stolen in 1992, he bought another one at a pawnshop, filling out the background-check form required by federal law. The problem for Mr. Mahoney was that 13 years earlier, he had been convicted of selling methamphetamine to an undercover police officer three times during the course of a three-week investigation. After the conviction, for which he served 22 months in prison, Mahoney cleaned up his act and became a law-abiding citizen. In

1991, he underwent an extensive background check to get a liquor license; because he had stayed out of trouble for over 10 years, the license was granted. Mahoney, wrongly assuming that his lone felony conviction had also been wiped clean with regard to his gun rights, marked down that he was not a felon on the federal background check form for gun purchases. A BATF investigation resulted in Mahoney's indictment as a convicted felon in possession of a firearm as a result of buying the Derringer in 1991. Under federal mandatory minimum sentencing rules, Mahoney's three drug sales during the 1980 investigation were treated as three separate offenses, making Mahoney a career criminal, and earning him a minimum sentence of 180 months. Though U.S. District Judge James D. Todd protested that Mahoney's was "not the kind of case that Congress had in mind," his hands were tied by federal law, and he had no choice but to put Mahoney away for 15 years.[12] Safe Neighborhoods promises to put over 800 full-time gun prosecutors to work. Add to this the fact that a job as a full-time gun prosecutor is likely to appeal disproportionately to attorneys with an ideological hostility towards gun ownership, and PSN begins to sound like something dreamed up by Sarah Brady herself.[13] As the program is implemented, expect more Michael Mahoneys to go down.[14]

Opening the Floodgates

Project Safe Neighborhoods offers an elegantly simple design for federal crimefighting: in the Safe Neighborhoods model, Congress picks a category of criminal offenses, then funds prosecutors at the federal and state level who do nothing but prosecute those offenses full-time. Elegant though this design is, it is dangerous both to federalism and the rule of law.

Do the Republican conservatives who helped enact PSN really want that program to become the model for federal anticrime initiatives in the future? If it does, it's difficult to see any stopping point to the politicization of federal crime policy. The program stands as an open invitation for special interest groups to push their own prosecution-stimulus initiatives. Are hate crimes your pet issue? Well, don't stop with the passage of a federal hate-crimes act—push for several hundred new federal and state prosecutors dedicated to bringing hate-crime indictments. The same method will work with sexual assault offenses. (*U.S. v. Morrison*, which struck down provisions of the Violence Against Women Act, establishes the unconstitutionality of federal legislation criminalizing rape and sexual assault. But it doesn't stand in the way of federal funds to hire full-time state-level sexcrime prosecutors.) Nor is there anything to stop child welfare advocates from promoting the funding of several hundred full-time state-level child-abuse prosecutors. In the past, conservatives have expressed serious concerns about whether overzealous prosecutors have repeatedly gotten swept up in the emotional nature of the child abuse issue and ended up incarcerating innocent people; federal subsidization of such prosecutions would only increase that risk.[15] But does anyone seriously expect more than a handful of Republican legislators to risk incurring the charge of being "soft on child abuse"?

The Republicans who backed PSN as a means of forestalling new gun-control legislation have been too clever by half. The principle they've endorsed not only runs roughshod over the idea that the states ought to be able to set their own prosecutorial priorities, it fairly begs for those priorities to be set by the most vocal and powerful interest groups in Washington.

Does It Work?

What are the likely effects of PSN on violent crime? What benefits do we get in exchange for weakening our federal structure and undermining the rule of law?

Not much, as it turns out. PSN has been dramatically oversold by politicians and political activists who see in it a means of warding off restrictive gun control legislation. First of all, the legal tools available to state prosecutors pursuing armed felons are, in many cases, essentially the same as those available to federal prosecutors. Second, there is very little evidence that Project Exile, the model for PSN, has been the impetus for any dramatic reduction in crime in any city where it's been implemented.

In *U.S. v. Jones*, a panel of three federal judges (E.D. Va) examined Richmond's experience with Project Exile, and concluded that Exile was superfluous, given that "the Commonwealth of Virginia possesses the same institutional mechanisms necessary to combat the problems Project Exile abdicates to federal prosecutors." According to the Court, the Virginia state statutes governing handgun crime are substantially similar to those at the federal level, and that in some cases Virginia law provides for harsher penalties for firearms offenses.

As for the efficacy of the program PSN is based on, the best available evidence says that Project Exile did little, if anything to reduce crime. Professors Jens Ludwig of Georgetown University and Steven Raphael of the University of California, Berkeley performed a comprehensive statistical analysis of Project Exile's effects on crime, in a study to be published in the forthcoming Brookings Institution book *Evaluating Gun Policy: Effects on Crime and Violence.* According to the study: "the decline in Richmond gun homicide rates surrounding the implementation of Project Exile was not unusual and… the observed decrease would have been likely to occur even in the absence of the program." As Ludwig puts it, federalizing gun crimes was "no magic cure."

Even if PSN had the dramatic impact on crime that its most ardent supporters argue it does, its affront to the Constitution and the rule of law would compel constitutionalists to oppose its expansion. But PSN's supporters have failed to produce any compelling evidence that the program significantly reduces violent crime. Given the costs federalization brings, that's a failure that should end the debate.

* Gene Healy is senior editor at the Cato Institute.

Footnotes

[1] "Remarks by the President at National Governors' Association Meeting," *U.S. Newswire,* February 26, 2001.

[2] See generally Adam H. Kurland, "First Principles of American Federalism and the Nature of Federal Criminal Jurisdiction," *Emory L.J.* 45 (Winter 1996).

[3] Federalist No. 17, in *Id.*

[4] *U.S. v. Jones*, 36 F. Supp. 2d, 304, 316 (E.D. Va. 1999).

[5] *U.S. v. Nathan,* 1998 U.S. Dist. LEXIS 15124 at *30 (E.D.Va. 1998).

[6] Attorney General Transcript, News Conference – Gun Initiative/NICS, February 13, 2002, available at http://www.usdoj.gov/ag/speeches/2002/021302newsconferenceguninitiativenics.htm.

[7] Jerry Seper, "Justice Takes Aim at Illegal Gun Possession," *Washington Times,* February 14, 2002.

[8] *Lopez,* 514 U.S. at 564

[9] Federal prosecutions under Project Sentry will likely be conducted under 18 USCS § 922(q), the revamped Gun-Free School Zones Act enacted in the wake of *Lopez*. (Public Law 104-208, signed by President Clinton on September 30, 1996). That act could be considered constitutional only under the narrowest possible reading of *Lopez*.

[10] Mark Fazlollah and Peter Nicholas, "U.S. Overstates Arrests in Terrorism," *Philadelphia Inquirer, December 16, 2001.*

[11] Heinzl, *supra* note 5

[12] Gary Fields, "'Career Felons' Feel the Long Arm of Gun Laws," *Wall Street Journal,* July 3, 2001, p. A16.

[13] For examples of the kinds of prosecutions that ideologically-driven prosecutors might bring, see, e.g., Guy Taylor, "Self-Defense Stance Defended on Web in Burglar Death," *Washington Times,* December 17, 2001, p. B1, detailing the state level prosecution, for first-degree murder and various gun charges, of two Maryland men who shot a burglar in self defense. As the state's attorney prosecuting the case explained, "We have a comprehensive strategy in Baltimore for dealing with crimes with guns and reducing gun violence… the killing of Mr. Walker was not a typical street crime, but it is a crime that needs to be prosecuted." See also Tom Schoenberg, "Does Punishment Fit the Crime? He Turned in Gun, Now Faces Deportation," *Legal Times,* January 24, 2000, p. 1, describing the prosecution, by the District of Columbia U.S. Attorney's office, of one Elwyn Lehman. Lehman, the driver of the tour bus for gospel singer CeCe Winans, brought the singer to the White House for a special tour. The 53-year-old driver had a handgun on board, but only realized this once he was at the gates of the White House. Lehman told the Secret Service officers about the pistol and voluntarily turned it over to them. He was rewarded with a trip to D.C. Jail and charged with three counts of weapons possession. Lehman, a Canadian citizen who had been living in the United States for the past 15 years, also faced deportation. As the spokesman for the D.C. U.S. Attorney's office explained, "because the District of Columbia, which has one of the strictest gun laws in the country, continues to be plagued by an alarmingly high rate of gun violence, the U.S. attorney's office has long had a no drop and zero tolerance policy regarding persons found in illegal possession of firearms."

[14] The incentives set up by PSN may well place Safe Neighborhoods prosecutors in an uncomfortable ethical bind. In some cases, a prosecutor has an ethical obligation to decline to prosecute when circumstances warrant it. The A.B.A. Standards state that "the prosecutor is not obliged to present all charges which the evidence might support." Among the factors which the prosecutor should consider in declining to prosecute are "the extent of the harm caused by the offense" and "the disproportion of the authorized punishment in relation to the particular offense or the offender." Will Safe Neighborhoods prosecutors be able to fulfill this ethical obligation?

[15] See, e.g., Dorothy Rabinowitz, "Only in Massachusetts," *Wall Street Journal,* December 29, 1999, P. A14; Dorothy Rabinowitz, "The Pursuit of Justice, Continued," *Wall Street Journal,* October 7, 1999, P. A30.

MR. MALCOLM: The debate about how to strike a proper balance between cherished privacy rights and the legitimate needs of law enforcement and the intelligence community is not a new one. This debate, however, has grown more vigorous and more vociferous and, of course, increasingly more important since the shocking and unprovoked attacks on the World Trade Center and the Pentagon on September 11th of 2001.

Although it is vitally important that we do everything we can to pursue and apprehend terrorists, I do not believe that, at least as it pertains to the Electronic Surveillance provisions, the U.S.A. PATRIOT Act signals some kind of fundamental shift between online privacy and Governmental power.

There are those who believe that with respect to many aspects of the war on terrorism and also with respect to the surveillance provisions in the U.S.A. PATRIOT Act, the pendulum has swung way too far in terms of denigrating privacy rights at the expense of law enforcement and intelligence gathering. In fact, I think there are those people out there who think that the Department of Justice is essentially acting like some voracious PacMan that's running around and swallowing civil liberties at every turn.

Still there are others who believe that the Government ought to be given even greater tools to protect the public from further harm. It is certainly true that the public at large expects us to use, in an appropriate manner, all of the tools that are in our arsenal, including those set forth in the U.S.A. PATRIOT Act to prevent additional attacks and to bring to justice those who were and are responsible for plotting against us. And, speaking, at least from the perspective of the Department of Justice, I believe that we are doing just that, and I'm unapologetic about it.

We recognize though that while desirous of feeling safe and secure, Americans are extremely reluctant, as they should be, to give up their privacy. Many are understandably on guard against what they perceive as Governmental overreaching at this time of crisis. This backdrop frames much of the debate about security versus freedom and explains much of the controversy that continues to surround the U.S.A. PATRIOT Act, and I assume will be surrounding it for years to come.

This is an important debate that is healthy for a free society which is governed by the rule of law. The Department of Justice has not abandoned the rule of law; we embrace the rule of law. I applaud all of those attorneys out there in privacy groups that are challenging government actions. These issues are being trumpeted in the public and talked about in front of Congress and talked about in the courts. That's good; that's the way it ought to be.

I believe, however, that in terms of advancing this debate, there has been a lot of misinformation and hyperbole about the scope of change brought about by the U.S.A. PATRIOT Act. In addition, there are provisions of the U.S.A. PATRIOT Act that in fact protect and extend civil liberties, including increased civil penalties for improper disclosure of surveillance information and new reporting requirements when the government installs its own pen trap device such as DCS-1000, which of course was originally referred to as Carnivore. I suspect that the person who originally named it Carnivore is one of those people who, as a previous speaker suggested, is now in the private sector. A lot of these privacy enhancing provisions have been roundly ignored by the press.

While there are those who contend that the U.S.A. PATRIOT Act has dramatically expanded the powers of law enforcement, I would contend that in fact it is a very measured piece of legislation. I'd like to begin with a brief overview of the PATRIOT Act and then discuss a couple of its more controversial provisions, specifically the pen register and trap and trace statute and its application to the Internet, and the computer trespasser exception, which Chris Painter talked about a little bit.

The U.S.A. PATRIOT Act provides the law enforcement and intelligence communities with new tools and resources to prevent terrorist acts and to apprehend and punish the perpetrators of such acts. Two fundamental objectives animate its provisions. First, to increase our surveillance capacities with respect to criminals and terrorist networks. Second, to enhance our abilities to swiftly track down and apprehend criminals and terrorists, hopefully before they act.

Now regarding the Internet and other electronic communications, the Act expands existing provisions that permit law enforcement, with appropriate judicial oversight, to intercept and access communications.

The U.S.A. PATRIOT Act accomplishes many of its objectives by updating surveillance laws to account for changes in technologies that have occurred over the intervening years, such as the increased usage of emails, the Internet, and cell phones by both cyber criminals and by terrorists. In this way it updates the law by making it technology neutral.

Just because new technologies have emerged, should that mean that criminals now have some new ways to thwart legitimate law enforcement activities? By means of the U.S.A. PATRIOT Act Congress has declared that cyberspace should not be a safe haven for cyber criminals, terrorists, and others who are bent on committing criminal activity. By the same token, the same privacy protections that were afforded to users of the telephone during its hay-day, have for the most part been extended to these new technologies, too.

Now as I previously mentioned, one of the more controversial provisions of the PATRIOT Act involves the application of the pen register and trap and trace statute to the Internet. Congress enacted the pen register and trap and trace statute in 1986, and it requires the Government to seek a court order for so-called pen trap information.

Now in rough terms, a pen register records outgoing addressing information, and a trap and trace device records incoming information. For the telephone a pen register would record the numbers dialed from a telephone, and a trap and trace device would record all the incoming numbers.

In 1979 the Supreme Court ruled that in the telephone context there was no reasonable expectation of privacy in this sort of non-content information, because it was shared by the user with communication service providers. This means that from a constitutional perspective there was no court order necessary in order for law enforcement to compel production of this information.

When Congress enacted the pen trap statute, thereby providing statutory protections that were not afforded by the constitution, it did not anticipate the new communication technologies which we have today, such as the Internet. Indeed, some of the language that Congress drafted in the original pen trap statute appeared to relate to the telephone only. For instance, it defined pen registers in terms of numbers dialed.

The PATRIOT Act updates the pen trap statute's language to make it tech-neutral, as it now applies more generally to dialing, routing, signaling, or addressing information. It also makes explicit that which had previously been implicit and constitutionally based, a distinction between content and non-content.

Thus, the pen trap statute now unambiguously applies to Internet communications, which could be interpreted, by the way, as another extension of civil liberties. If something wasn't constitutionally based and the original statute didn't apply, arguably law enforcement didn't need any kind of a court order in order to get this information. Now the pen trap statute clearly applies to the Internet. Clearly you have to get a court order.

However, the pen trap statute's new language does not constitute a significant expansion of Government power. In fact it's hardly an expansion at all. Prior to the U.S.A. PATRIOT Act, the Government was already using the pen trap statute, adopted almost universally by every court to consider the issue, in order to get non-content information in many jurisdictions. The PATRIOT Act has simply confirmed that this was a proper course of action.

Consider, for example, the case of James Kopp. You may recall that he was indicted for the murder of Dr. Barnett Slepian, who was an abortion doctor in East Amherst, New York. Mr. Kopp, who was wanted by law enforcement officials, communicated with his cohorts through a shared Yahoo account. To avoid sending emails, they left messages for each other in the account's drafts box, which they then accessed through the Internet.

Federal prosecutors sought a trap and trace device in order to get information concerning the IP addresses from which the account had been accessed. Through that information, Mr. Kopp was traced to France, and he was arrested. This happened in February of 2001, during the very early days of the Bush Administration, long before the events of September 11th and long before the enactment of the U.S.A. PATRIOT Act. Mr. Kopp has been extradited here. He is now awaiting trial.

Next let's consider the U.S.A. PATRIOT Act's computer trespasser exception, also known, as Chris Painter already told you, as the hacker trespass exception to the Wire Tap Act. This provision generated a surprising amount of opposition. A good portion of that resistance, I believe, comes from people who simply don't understand what it is.

For example, there was one senator during the debate who said that the hacker trespass exception could be used to monitor the emails of an employee who has used her computer at work to shop for Christmas gifts. This is simply untrue.

All right, so what is the computer trespasser exception? To explain, I'd like to give a very brief overview of the Wire Tap Act, which provides the statutory framework governing real time electronic surveillance of the contents of communications.

The structure of the Wire Tap Act is surprisingly simple. The statute's drafters assumed that every private communication could be modeled as two-way connection between two participating parties, such as a telephone call between Person A and Person B. The statute prohibits a third party, such as the government, from intercepting private communications between those parties using an electronic, mechanical, or other device absent a court order, unless one of several statutory exceptions applies.

Now under this general framework, as it applied prior to the PATRIOT Act, the communications of network intruders, which may be routed through a whole series of compromised computers, could be protected by the Wire Tap Act from interception by the government or any other third party. The PATRIOT Act simply enacted another exception to that rule.

The computer trespasser exception allows victims of computer attacks to authorize law enforcement to intercept the wire or electronic communications of a computer trespasser. It includes several significant limitations which ensure that it does not expand beyond its core function.

First, the owner or operator of the computer has to authorize the interception of the trespasser's communications. More importantly, the interception cannot acquire any communications other than those that are transmitted to or from the computer trespasser.

Finally, the exception may not be used when the party that's going to be monitored has an existing contractual relationship with the owner or operator of the computer. They may be going beyond the extent of that authorization, that contractual limitation, but if they have an existing contract, they are not an outside hacker. Therefore, an entity's legitimate customers and employees can't be monitored under this exception. In sum, the statue was crafted carefully to ensure that the government is only monitoring outside trespassers.

Now, although narrowly confined in scope, the computer trespasser exception is a significant new tool for law enforcement. For example, weekly we read about successful distributed denial of service attacks on computer systems all around the country. Typically these attacks are channeled through zombie computers that have been compromised and which are owned by innocent third parties.

The computer trespasser exception gives law enforcement the ability, with the consent of that innocent third party, to monitor the communications through their computers. Now some have criticized the computer trespasser exception as somehow restricting the judicial role in investigations. You've heard a lot about that.

It's true that without this exception, law enforcement would have to make a probable cause showing before a

magistrate before intercepting a hacker's communications. However, I believe that the hacker trespass exception again strikes an appropriate balance between privacy and law enforcement.

When a citizen finds a burglar in his basement in the middle of the night, he wants to protect his family, find out who this person is, and why that person is there. When that citizen calls the police, he wants and deserves immediate action. By being able to act immediately, the odds of the police catching the burglar before real harm occurs goes up dramatically.

When the law enforcement officer gets that call, he has no need to wake up a prosecutor or judge in the middle of the night in order to get a warrant. The burglar has no right to and no reasonable expectation of privacy to prowl in the middle of the night in someone else's basement. The same is true in the online world.

A computer hacker who is acting without authorization has no right to and no reasonable expectation of privacy in routing around in somebody else's computer system. Just as there was no need in the real world example to wake up a prosecutor and a judge, there should be no need for a prosecutor and a judge in the online example. There is no legitimate privacy expectation that would be served by requiring a court order and judicial oversight in this situation.

Moreover, just as it's impossible to tell who's in the basement, when a computer hacker enters into a sensitive network, it's impossible to tell whether that hacker is a script kiddie who wants to do something malicious, route around, maybe deface a page, or something like that, or whether we are talking about somebody who is a serious cyber criminal, or a cyber terrorist, who is plotting an attack, who is trying to get valuable critical infrastructure information to create a threat to life and limb.

Under these circumstances, time is of the essence. By being able to act immediately, the chances of finding out who that hacker is, what that hacker wants to do, and catching that hacker increase immeasurably to prevent real harm both to the immediate victim and also possibly to others who might be harmed by that intrusion.

In conclusion, I want to say that I think it's entirely appropriate following September 11th to ask questions about the balance that has been struck between privacy and law enforcement and security. It's entirely proper to ask such questions. I think it's great.

However, I think the U.S.A. PATRIOT Act demonstrates that, at least in the Internet context, what was needed was simply a tune-up. It wasn't a major overhaul. Congress updated the statute to accommodate for new technologies and new situations. It did so in a manner which remains faithful to old principles and long-standing constitutional doctrines.

The debate about privacy versus security is not likely to end any time soon. These are difficult times, and difficult questions that we face. Nobody should claim to have all the right answers, because none of us is omniscient. It is entirely appropriate that we have debates like this in symposiums, in courts of law, and within the Executive Branch and also in our dealings with the Legislative Branch.

Obviously there is going to be oversight. A lot of these provisions are sun-setted. We have people like Larry Thompson who go up to the Hill on a regular basis to report on these things. There is judicial oversight. We'll see where this goes.

Thanks for inviting me. I'll be happy to take your questions.

MR. CLARK: Thanks. Drew Clark, National Journalist Tech Daily. At presentations such as this it's natural that the Justice Department would want to put the most favorable interpretation of legislation on the table, and you have done that and I appreciate your tone. I just must ask, all of the things that you didn't mention, the things such as the secret searches that are now enabled and not sun-setted. For example, I guess the most important piece about which I'd really be interested in your reaction, is the changes to the Foreign Intelligence Surveillance Act, and how that opens the door to new expansive searches of individual citizens without probable cause to believe they have committed any crime whatsoever, and indeed the opening up of third-party and educational records under the FISA provisions that are now possible.

MR. MALCOLM: I've got to write down the ones you've asked me about. Hold on a second. Go ahead.

MR. CLARK: Yes, there are some privacy provisions as you point out in the statute, but I guess I feel compelled to point out each of those provisions you mentioned were the result of a legislative compromise that was not originally proposed by the Justice Department. The Carnivore reporting was Mr. Armey's insistence. Changes to the computer trespassing were narrowed because of Senator Leahy's objections. So I guess I raise that to point out that yes, it's notable as you point out, it's important to have this debate, but these weren't suggestions the Justice Department came forward with. They were only added at the insistence of Congress.

So any reactions to those points that I've made?

MR. MALCOLM: I'll react to all of them. I'll take your last one first. We live in a system of checks and balances. That's great. We have two major parties, multiple other parties, three branches of Government — Federal system and the state system — and they're all supposed to be questioning each other. They're all supposed to be looking at each other. Things are often a series of compromises.

If you were to look at the Administration's original bill, there may be certain provisions that you thought were way over the line. I certainly think there were good justifications to support all of those provisions. Did they get compromised? Sure. Did they get weakened in some instances? Probably. Did they get strengthened in some instances? Probably. Did some ideas originate within the government? Yes. Did some ideas originate within Congress? Yes. Did some ideas originate within privacy groups? Yes. That's good.

I don't think, though, that it's an accurate characterization to say that after September 11th, the U.S.A. PATRIOT Act was drafted by the government as some kind of Christmas tree that was going to go and steam roll across the country as a complete wish list of Government actions. I think that it was

tempered by Congress as it deemed appropriate. That's the way our system operates, and I see nothing wrong with that at all.

I don't think it's accurate to somehow say "Well, had it been up to the Executive Branch, the Constitution would have somehow been done away with, and it's only Congress that saved it." I think there was a lot of give and take in the PATRIOT Act.

With respect to so-called sneak and peek searches, the idea that you can go in with a court order, not knock and announce your presence, but go in secretly, search for something, or implant a device, is not terribly new.

There are Title III orders (Title III has been around for a long time), for instance, in which you get a court order to go in and plant a bug, say to go plant a bug in a mobster meeting room, that takes place under cover of darkness. People don't know that an agent has been there. They don't know an agent has left. Hopefully they don't find the evidence that indicates that an agent has been there.

All this does is apply this mode of operation to the search context. Sneak and peeks have been done in the drug area for a long time. So I think this is really a clearer codification of what was existing all along. I don't think that there's anything particularly novel about that. A lot of times you need to go in somewhere where a crime has occurred or is being plotted and get the best information that you can. But it's not an appropriate time to bring down an investigation. You want to develop leads. There's judicial oversight there.

It's not as if United States Government agents are knocking on the door or breaking in at night without any kind of oversight. All of these situations involve going in front of a judge and saying why you believe evidence is there and why you believe you need to get in there, and why there is a need to do this secretly and not to leave a sign, a calling card, that you've been there. So there's appropriate judicial oversight to that, and I don't think that it's a particularly new law.

With respect to the FISA Court changes, I assume you are talking about the balance between law enforcement and the intel community — to those of you who may not know what we're talking about, and of course if you were referring to something else, let me know — the FISA Court is the Foreign Intelligence Surveillance Court. It's a special court that sits within the Department of Justice that enters orders in cases involving — not necessarily terrorists, it can involve terrorists — but it can also involve espionage. It involves foreign powers and agents of foreign powers conducting something of interest to the intelligence community.

The FISA Court orders do not have a lesser showing to make; they have a different showing to make than one would have to make before a judge in a criminal case in which you need to show probable cause that a crime has occurred and probable cause to believe that evidence is in a particular location.

The FISA Court rules, which are set forth in the Foreign Intelligence Surveillance Act, had a provision that said that if you got a FISA Court order with this sort of surveillance by a FISA Court judge, that the primary purpose had to be for intelligence gathering. It didn't say that there couldn't be some correlative law enforcement purpose, but that the primary purpose for the order was for intelligence gathering. It was designed to separate the intel side of the house from the law enforcement side of the house.

The showing that had to be made had less to do with whether or not there was a crime being committed. Frankly, some of the stuff may or may not be a crime, but you're going to gather intelligence to see whether or not somebody is harming our national interest, that is the showing that you had to make by probable cause was that there was a foreign agent involved or a foreign country involved or an agent of a foreign power. So you still had a showing to make, and there was still a judge there who determined that.

The FISA Court statute has been amended to change the word primary to significant. The law enforcement and the intelligence community have always worked to some degree together in the FISA Court context. However, you could now have a situation in which a law enforcement objective is the primary reason to go to a FISA Court, and regarding the intelligence aspect of things, there's a significant purpose for it. It doesn't have to be the primary reason. There are a lot of people who are very concerned about a weakening of this wall of separation between the intel community and the law enforcement community.

There's only so much that I can say about it, because the matter is currently in litigation before the FISA Court Appeal Board. For the first time in the history of the statute such an appeal has been taken, and there was a court order issued by the FISA Court questioning the legitimacy of this change. I guess my response is (1) it's a change that Congress made; and (2) this was not hidden. The purpose for this, at the time that Congress considered it, was all within the Congressional record. I suppose the major reason to justify this change is because the lines in the terrorism context and the times we're facing now between law enforcement and intelligence gathering have largely blurred. They've blurred for several reasons. One, we had a shocking revelation that there were intelligence failures prior to September 11th. There are people out there now who are saying "Why didn't you connect the dots? There were signs out there that you should have read, and if you had read them, disaster might have been averted." Well, I don't know whether there were enough dots out there in order to avert a disaster. That's one of those unknowable questions.

However, it is true that we need to do a better job about connecting dots. We've literally had situations, in which the intel community was gathering information about potential terrorist attacks, which of course involves criminal acts as well, and you had the criminal law enforcement community within the context of grand jury proceedings, which are secret proceedings, gathering information about criminal activity that could implicate a terrorist attack. The two sides weren't talking to each other.

We need to find a way to get them talking to each other. In addition to that, the lines are blurred because people now realize that law enforcement, stopping people and arresting people, can be a legitimate tool in intelligence collection in the same way that intelligence collection can be a legitimate tool to aid law enforcement. It is a change. I don't think it's a dramatic change. It's a change of emphasis. The matter is in litigation. Those are the reasons for the change. You can agree or disagree with them.

I believe you also talked about records searches. I assume that mostly what you are concerned about are library searches. Is that fair?

MR. CLARK: Yes, but I think it's broader than that.

MR. MALCOLM: It is broader than that. I'm not completely familiar with all of the parameters of this. Please forgive me, but I will tell you what I can tell you, which is I don't think that there's any secret that after September 11th it was discovered that a lot of these terrorists, Mohammed Atta and the lot, did a lot of communicating in libraries on the Internet. They're there; they're accessible; you can use them and remain relatively anonymous. I think it is safe to say that libraries contain useful information for law enforcement in both criminal investigations and terrorism investigations and also for the intelligence community.

There is obviously a high degree of skepticism about law enforcement activity involving libraries, because a lot of legitimate First Amendment protected activity takes place in libraries: what you read, what you look at. The overwhelming majority of people who are there are there for perfectly legitimate purposes, and it shouldn't really be anybody's business what it is that they're reading.

I hear you. I'm with you. I also understand that there is a history of FBI abuses to some degree in that area. There were references to the 1960s civil rights era in which FBI agents were keeping files on people who were engaging in First Amendment-protected activity that was somehow unpopular within law enforcement's counter intel program. That's part of the FBI's history. We don't want to forget the lessons of history.

The guidelines that are in place for library searches reflect a recognition of that history and a wish to avoid repeating that history. One, an FBI agent can't just go in and get these records. He again has to go to a FISA Court judge or a designated magistrate, make the appropriate showing, and get a court order.

Before you ever get to a FISA Court, the FBI guidelines in this context require approval, several levels up the chain. They make very clear that there have to be legitimate law enforcement or intelligence purposes to get this information that is not protected by the First Amendment. You've got to show that there is some real likelihood that there's going to be something there showing nefarious activity that can harm our national interest in a very serious way.

So is that something to be watched? Yes, it's something to be watched. Should there be oversight over that? Yes. But there is quite a bit of oversight built in to the system that's now been changed, and let's hope that those tools are used appropriately and that they won't get abused.

MR. CLARK: Why isn't the Justice Department responding to the House and Senate Judiciary Committee request for information about oversight if there is oversight, and you expressed the desire that there be oversight? Why aren't you responding to those requests?

MR. MALCOLM: I didn't express the desire that there be oversight, but I think it's perfectly legitimate to have oversight. Actually, no, I think it's a good thing to have oversight; of course it's a good thing to have oversight.

I think that's painting with a broad brush to say that the Department is not responding to requests.

MR. CLARK: That's not answering the question.

MR. MALCOLM: Well, wait a minute. I think that's painting with a broad brush. There are, as you know, many, many subcommittees within Congress. All of the Senators and the Representatives in the House have all been elected. They're all important people; they all have a right to ask for and get information.

On the other hand, there's a lot of work to be done. The Justice Department's got a day job, too, of catching criminals and fighting terrorism. If every Congressman or Congressional subcommittee is asking for information, there's a lot of duplication that is going on. Not to mention the fact that a lot of the information that's being requested is classified. There are certain subcommittees that are set up specifically to deal with classified information.

So, one, there are appropriate channels to funnel information to Congress, appropriate subcommittees. Just because one subcommittee is upset about the fact that it's not receiving information does not in fact mean that that information is not being relayed to Congress. Part one.

Part two, there are, as you know, and this is nothing new, legitimate disagreements of opinion about what is producible. Congress has its view of Executive privilege and the President's constitutional prerogatives. The Executive Branch has its view about internal deliberation and Executive privilege material that should not be turned over.

It's not unique to the area of terrorism. You see this for instance in the fight over judges. Ask Miguel Estrada about whether or not his memoranda from the time that he worked in the Solicitor General's office ought to be turned over to the Senate Judiciary Committee. The Executive Branch has taken the position, as have a number of Solicitor Generals, both Democrat and Republican, that this is internal deliberation material and in an Executive Branch context and should not be producible under the Separation of Powers Doctrine.

The same debates though apply with respect to intelligence and law enforcement. I don't think that it's fair to say that the Administration is somehow sticking it to Congress. We are working with Congress to see to it that Congress can satisfy its legitimate oversight activities while at the same time doing the job of protecting our country and also protecting the Executive Branch. It's not just for this administration; it's also for future administrations.

MS. KAPLAN: Hi, I'm Kathleen Kaplan from Howard University. One of the things when you were talking that came to my mind was this information overload. As a lowly professor at Howard, I get 50 to 100 emails a day, which is like reading a book every single day.

MR. MALCOLM: Tell me about it.

MS. KAPLAN: So, is some of the problem just information overload with catching these cyber criminals and other types of criminals. Where you get so much information, how are you going to determine what's important and what's not?

MR. MALCOLM: I don't know. I'm not 100 percent sure I know what you mean, but let me try to tackle what I think you mean. It's a difficult question. We're being bombarded with information. I have the greatest sympathy for people, for instance, who say "Okay, we're going to raise the level of alert status from yellow to orange. But they're non-specific threats; we can't tell you when they'll occur, and we can't tell you where they'll occur or if they'll occur at all."

What do you do in response to that? I understand that. It's difficult to process that sort of information. It's a little bit, however, a situation of (1) there are a lot of people out there that are seeking that information who get very upset when you don't give it, and (2) there's a little bit of a damned if you do and damned if you don't.

If you give the information, you're accused of panicking the public and overloading folks. On the other hand, if you don't give that sort of information, and God forbid something does happen...let's face it, we live in perilous times. We have enemies abroad. There are soldiers fighting now. We have enemies within our borders, terrorist cells, people who are bent on our destruction, living right here within our shores.

If you don't give that information and people don't act in an extra vigilant manner and take whatever precautions they want to take, they avoid taking an unnecessary flights or a trip or what have you, then they'll say "You mean you knew that and you didn't tell us about it?" It's tough.

We live in a time of instantaneous news. You can get it over the Internet from any number of channels. You can get it on cable TV from any number of sources. A lot of us are news junkies. How you take that information and process that information, we all struggle with that. I get more than 50 emails a day.

The public has a right to know about it. Whether you choose to tune it out or pay attention to it, that's an individual choice.

MR. FOREMAN: Frank Foreman, U.S. Department of Education. Since this is the Federalist Society, let me ask a Federalism question. More specifically for you, what are the sorts of things that the states and local governments are incapable of doing?

MR. MALCOLM: Are capable of doing?

MR. FOREMAN: Capable and incapable of doing as far as cyber crime is concerned.

MR. MALCOLM: Well, you can give an answer with respect to cybercrime and with respect to all sorts of crimes, including terrorism, including organized crime. States have certain advantages over the Federal Government when it comes to law enforcement. The Federal Government has certain advantages in law enforcement vis-a-vis the states.

In terms of crimes that are taking place within a state, there's your local law enforcement officer who's going to know the business community, those people on the ground, know the neighborhoods where criminals are acting, be able to go out on the street and have that day-to-day contact with folks, and do a very effective job of rooting out crime, much of which will be intrastate, some of which will be interstate. They can do so perfectly well without the intervention of the FBI or Secret Service or DEA or whoever, thank you very much.

However, the Federal Government has more resources that it can bring to bear in certain specialized cases. It has certain expertise that it can bring to bear in certain cases.

I'll give you a good example. It is cybercrime and it's not cybercrime. It crosses into the area that the gentleman in the back asked about before, because it involves child porn. Many of you may have heard about the CandyMan case.

The CandyMan was an email group that was distributing child porn internationally and across many, many states in this country. Now if you look at an individual group member in one particular jurisdiction, maybe you can take the idea that "Okay, all child porn is just bad period. Even if there's only one perpetrator, we're going to investigate it thoroughly and we're going to prosecute it."

However, using that as an example, you can have crime that is in fact broad ranging. In any one state the consequences may not be serious enough to justify having the state use its local scarce resources to fight that problem. They may do so because they lack the resources and don't have the intelligence to get the big picture and to realize that what's a small problem in this state is in fact a very large organization and is affecting many, many, many states.

Those are the sorts of resources that the Federal Government can bring to bear. It can look and say, "Well, you know, it may look like a small problem, but it's a small problem here, and in this city, and in Arkansas, and in Nevada, and in Utah, and in Maine. When you add it all up, it's a pretty big problem." We have the resources and the ability to look at the totality of that and to really hit these people who are perpetrating this heinous activity hard in a way in which the locals can't.

Obviously there's a big concern, which is an entirely different debate topic near and dear to the Federalist Society's heart, about the federalization of crime. One, from a constitutional perspective, and two, from a resource perspective. Federal resources are not limitless. They are also specialized, and you want to make sure that they are being used to maximum advantage. So where do you cross that line between Federal resources and state resources? When do you choose to deploy Federal resources? A lot of the time we work in task forces; we work in coordination with each other. That has to be done occasionally.

MR. FOREMAN: Is cybercrime substantially different from other kinds of crime in a way, as far as the Federal state balance would turn out?

MR. MALCOLM: Well, it's substantially different. One, in that there tends to be more expertise, although we're trying to remedy that, at the Federal level than at the state level. Two,

people who perpetrate cybercrimes have the ability to cast a very, very broad net. They can perpetrate this crime far and wide.

Let's take a simple example. Your Nigerian scam letter. We all used to get one or two of those letters. It used to be that somebody had to sit in a room, draft this letter, sign this letter, stick it in an envelope, put on a postage stamp, and send it. Then if it came back, they had to keep a file of who they contacted and how much money they got and what letter the victim had gotten in the scam.

Now with the computer, you get these letters all the time. It's easy. You draft it up online and you send it out all over the world. If you get a positive response, it goes into one database; if you get a no, it goes into another database.

So any criminal activity, if you use the computer as a facilitating device, can be spread astronomically. Well, locally the government can't handle that. It doesn't know the scope of what's out there. It doesn't have the law enforcement tools — maybe some states do, but by and large they don't have the law enforcement tools to take on that sort of activity. They don't tend to have the expertise, although we are working very closely with groups like the National Institute of Justice to remedy that as quickly as we can.

AUDIENCE MEMBER: I have a question, I want to go back to the oversight question that Drew was asking. This is really a factual question from my ignorance, no doubt, of the PATRIOT Act. When you were talking about the example of the library search, there is a perception out there, and I hope you can counter it to assure us all, a perception of the sort of star chamber quality to these matters.

You mentioned there are FBI guidelines, approval up the chain of command, but of course still within the FBI. An application made to a court that is, as you say, within the Justice Department. Who does now, is there independent focus of those decisions?

MR. MALCOLM: The Court meets within the Justice Department. The Court is made up of Article III judges, life tenured, nominated, confirmed by the Senate, a separate branch of Government. These are not people who are in any way, shape, or form toadies to what the Executive Branch of the Federal Government would like to have happen.

We live in an open society. Unfortunately, because of the dangers that we confront, there is information of a very secret nature that has to remain secret. If you tell it to people, your sources and methods are compromised. What you know is going to be out, and perhaps what is more important is what you don't know. People will be able to rearrange their plans, alter their strategies, have a greater chance at perpetrating their crimes, or to avoid detection.

If we're conducting an intelligence investigation, let's say of a hostile government or maybe even an ally trying to gain a competitive advantage or to make up for a technological deficiency. It may be economic espionage. If you have that information out in the public, you've completely defeated the purpose of the investigation.

I mean no more that you would want to have Donald Rumsfeld sitting with the Joint Chiefs of Staff holding a public hearing and taking questions about where they're going to attack tomorrow. You can't be in the position of telling people who are bent in a literal way, on destroying us where we think they're going to strike next.

So what you do is try to have appropriate oversight and make sure that due process is followed. We try to be as open as we can. There are times, however, in order to protect our national security and insure domestic tranquility, which is a constitutional mandate, that there's a need for secrecy.

MS. EDWARD: My name is Abigail Edward and I'm an Assistant State's Attorney. Let me just preface my remark by saying that I understand working in the criminal field for a very long time. In no arena that I have been in have I ever found the cooperation among and between law enforcement and prosecutors as great as in cybercrime. It is a remarkably cooperative experience.

My question is a follow up to the previous gentleman, who was asking about the Federal balance. Do you think that that Federal balance changes as you differently define cybercrime? I think that the trouble with the definition of cybercrime is that what we term cybercrime here has been Internet crime. If you conclude that cybercrime also is an attack on a computer, which is very often done by disgruntled employees, which is a purely local matter, or could be, it could change the federal balance dramatically in my view. I wonder if you have any thoughts on that.

MR. MALCOLM: Just because we have an insider perpetrating the cybercrime doesn't mean it's not a Federal crime.

MS. EDWARD: It does not have to be, but it could be.

MR. MALCOLM: With respect to many statutes, there is concurrent jurisdiction. I supposed state laws vary from state to state, but a lot of times there's concurrent federal jurisdiction. The overwhelming majority of prosecutions take place at the state and local level precisely for that reason. There's no need to spend scarce Federal resources prosecuting every crime that could be prosecuted as a Federal crime.

There are a lot of crimes that have a peculiarly local impact. I would imagine that that balance takes place at a practical, on-the-street, in-the-office, where-prosecutors-and-law enforcement-agents-are-meeting level. It's not taking place at a more theoretical constitutional level.

If you have an insider perpetrating the crime, if we're talking about a computer network, I venture to say that all the companies that are here today that earn their daily bread online, your customers don't all come from within the state.

So if you have an insider wreaking havoc, it's going to have dramatic implications to people all over the country.

* John Malcolm is Deputy Assistant Attorney General, Criminal Division, U.S. Department of Justice. His remarks were the luncheon address at the Federalist Society's Cybercrime Conference on October 3, 2002 at the George Mason School of Law.

Environmental Law & Property Rights

Searching Private Businesses and Other Property Without a Warrant:

When Does Fourth Amendment Jurisprudence Make it the Rule Rather Than the Exception?

*By Gregory D. Page**

When the police or other Executive Branch officers conduct searches under civil and environmental statutes, settled Fourth Amendment jurisprudence provides them with substantially more constitutional authority to search private businesses without a search warrant than to so search private homes. The Supreme Court developed the jurisprudence allowing government officers to conduct a warrantless "administrative search" by construing two independent clauses of the Fourth Amendment: the Fourth Amendment protects the "persons, houses, papers, and effects" of the people from (1) "unreasonable searches and seizures" ("unreasonable search clause") and (2) government overreaching pursuant to search warrants issued for less than traditional "probable cause, supported by Oath or affirmation, and particularly describing the place to be searched, and the persons or things to be seized" ("warrant clause").[1] In construing these clauses, the Court has determined that they both authorize and limit different searches under different circumstances.

Generally, the Supreme Court construes the warrant clause to require a stricter burden of proof than the unreasonable search clause. Under the warrant clause's probable cause requirement, the government must submit evidence that a given search should be conducted at a particular place because a particular individual or entity may be guilty of or complicit in wrongdoing. Accordingly, the warrant clause requires more evidentiary suspicion particularized to a given individual than the general legislative or other societal standards presumptively available under the unreasonable search clause to define reasonableness according to desirable majoritarian goals. Thus, in comparing the reasonableness standards governing warrantless administrative searches of private property to traditional probable cause, the Supreme Court has determined that certain administrative searches are limited not by traditional probable cause, but "merely to a requirement of reasonableness."[2]

To decide whether to apply the unreasonable search clause or the warrant clause's stricter evidentiary requirements, the Supreme Court has analyzed the extent to which a given search would contravene a reasonable expectation of privacy. In Justice Harlan's famous balancing formulation, a protected Fourth Amendment interest exists where (1) an individual exhibits an "actual (subjective) expectation of privacy and (2) that expectation is "one that society is prepared to recognize as 'reasonable.'"[3] Thus, where the expectation of privacy is deemed either traditional or otherwise reasonable, the Court generally reviews a disputed search by applying the warrant clause's stricter probable cause standard. Conversely, where the privacy expectation is deemed unreasonable or diminished, the Court frequently construes the unreasonable search clause by applying more malleable definitions of societal reasonableness.

Under the Supreme Court's reasonable and individual expectations standard, the expectation that the possessions and other things in a private house are private and inviolate has been deemed both fundamental and eminently reasonable. Accordingly, absent consent, an applicable criminal sentence necessitating a subsequent search of a parolee, or exigent circumstances, such as the imminent destruction of evidence, a private home may not be searched or otherwise entered to effect arrest without a warrant.[4] Similarly, absent such circumstances, government officers may not search businesses or commercial property for either contraband or evidence of crime without a warrant.[5]

However, where the government searches business or other commercial property pursuant to certain types of environmental or other administrative statutes, the Supreme Court generally deems most individual expectations of absolute privacy either unreasonable or otherwise diminished. Thus, the Court has held that individual owners of commercial properties have a "reduced expectation of privacy" that "may, in certain circumstances, be adequately protected by regulatory schemes authorizing warrantless inspections."[6] Plainly, the Fourth Amendment's text does not distinguish between a private dwelling and a private business, perhaps because significantly more people lived and worked in the same place in the 18th Century than in the 20th and 21st. However, the Framers arguably used different words in different clauses of the Fourth Amendment to distinguish between permissible searches that were not "unreasonable" and valid searches authorized by a warrant for which there is "probable cause." Thus, these words do not expressly prohibit judges from distinguishing between valid searches conducted by warrant and searches that are otherwise reasonable.

In construing the word "unreasonable" in the unreasonable search clause, the Supreme Court has held that environmental or other administrative statutes of which the property owner is or could have been aware may define the standards for conducting a constitutionally reasonable warrantless search. Generally, the Supreme Court deems warrantless searches of commercial property reasonable and therefore permissible if (1) "warrantless searches [are] necessary to further [the] regulatory scheme" of an environmental or other administrative statute; (2) this regulatory scheme advances "substantial" government interests; (3) the relevant statute both supplies reviewable standards for the scope

and frequency of searches and tailors those searches to its regulatory rationale; (4) these standards confer something less than "unbridled discretion" on government officers; and (5) the statute accommodates special "privacy concerns," for example, by prohibiting forcible entries and requiring the government to obtain injunctive relief.[7] The Supreme Court has held that a statute meeting these reasonableness standards is a "constitutionally adequate substitute for a warrant" and, therefore, may authorize a search without the probable cause mandated by the warrant clause.[8]

There are at least three actual or potential consequences of authorizing a given warrantless search of commercial property under these comparatively flexible reasonableness standards First, unlike the constitutional liberties of free speech and free religion, this variable privacy standard allows Congress, in conjunction with the Executive Branch, to use flexible legislative standards to define and redefine the very constitutional right of privacy by which both legislatures and executive officials, under the Bill of Rights, are intended to be constitutionally restrained. By definition, rational legislative standards authorizing warrantless searches, even those tailored to a specific regulatory goal, are comparatively easy for rational legislatures to formulate and enact. Thus, Congress is comparatively free to expand the scope of governmental searches by substituting general legislative standards not requiring particularized evidence of individual guilt or wrongdoing for the warrant clause's probable cause requirement. Because these legislative standards give the police and other Executive Branch officials more discretion to balance individual privacy rights against the societal interests protected by Congress, the Court's administrative search requirements transfer power from judges, who otherwise would weigh particularized evidence of individual guilt in considering a search warrant request, to the legislative or executive officials authorizing or conducting warrantless administrative searches.

Second, the Court's application of the unreasonable search clause makes it easier for government officials to use administrative searches as a pretext to avoid or "crossover" the warrant clause's probable cause requirement for obtaining evidence of criminality. Where general legislative standards properly authorize an administrative search, "the discovery of evidence of crimes in the course of an otherwise proper administrative inspection does not render that search illegal or the administrative scheme suspect."[9] Finally, where an environmental or other administrative statute authorizes administrative officers to issue search warrants themselves, supported by the same legislative standards that also authorize warrantless searches, it also empowers government officials who may be less neutral than federal judges to authorize searches without probable cause. As Justice Scalia has noted, the "'neutral officer'...envisioned by our administrative search cases is not necessarily the 'neutral judge.'"[10]

Despite these risks, Justice Scalia and his brethren have decided that, if the Framers intended to describe the same type of valid government search in the Fourth Amendment's unreasonable search and warrant clauses respectively, they would not have used different words in different clauses to describe potentially different searches. Thus, a more realistic basis for evaluating administrative searches may be to inquire whether a given legislative or adjudicative standard protects the same privacy and concomitant liberty interests that the warrant clause protects, without needlessly impairing the environmental and other regulatory interests underlying the Supreme Court's decision to interpret the unreasonable search clause by applying more contemporaneous legislative definitions of reasonableness.

Plainly, legislative standards that narrowly tailor the scope and duration of administrative searches to particular environmental or other goals can advance one of the Fourth Amendment's contextual goals: eliminating the arbitrary discretion of executive officers "to decide where to search and whom to seize."[11] Arguably, narrow legislative standards of which property owners know well in advance can provide more advance notice than the sudden outcome of a judicial warrant, generally sought in camera by police and, therefore, frequently unexpected until served. Legislative standards could also protect individuals from the "cross-over" problem, by which executive officers conduct a warrantless administrative search solely to obtain criminal evidence, thereby circumventing the warrant clause's stricter evidentiary requirements. The same civil statute, for example, that authorizes a warrantless administrative search could also provide a separate cause of action for those demonstrating that a particular administrative search was actually a pretext to obtain criminal evidence without probable cause.

* Gregory D. Page is the Chairman of the Enforcement and Compliance Committee.

Footnotes

[1]U.S. Const. amend. IV.

[2]*Griffen v. Wisconsin*, 483 U.S. 868, 877 n.4 (1987).

[3]*Katz v. United States*, 389 U.S. 347 (1967).

[4]*See e.g., Steagald v. United States*, 451 U.S. 204 (1981).

[5]*G.M. Leasing Corp. v. United States*, 429 U.S. 338, 352-359 (1977).

[6]*New York v. Burger*, 482 U.S. 691, 702 (1987); *Donovan v. Dewey*, 452 U.S. 594, 598-599 (1981).

[7]*New York v. Burger*, 482 U.S. 691, 702-704; *Donovan v. Dewey*, 452 U.S. 594, 599, 604.

[8]*Burger*, 482 U.S. at 711; *Donovan v. Dewey*, 452 U.S. at 603.

[9]*Burger*, 482 U.S. at 716..

[10]*Griffen v. Wisconsin*, 483 U.S. 868, 878, 878 n.4 and n.5 (1987).

[11]Morgan Cloud, *Pragmatism, Positivism, and Principles in Fourth Amendment Theory*, 41 UCLA L. Rev. 199, 296-297 (1993).

Courts Frown on Economic Development Condemnations in 2002

*By Dana Berliner**

While municipalities and states continue to aggressively court private business by offering them other people's land, their efforts met with decidedly unfavorable results in the courts this year. In the first state supreme court decision in recent years to consider the constitutionality of condemnation for private commercial development in the absence of blight, the Illinois Supreme Court rejected the condemnation, commenting that "eminent domain should be used with restraint, not abandon." Other state courts also rejected so-called "economic development" condemnations and projects on statutory and semi-constitutional grounds. Even the federal courts enjoined economic development condemnations. New York, however, maintained its policy of approving economic development condemnations. Despite that, 2002 certainly continues the trend of courts telling redevelopment agencies that it's time to put on the brakes.

The Illinois Supreme Court of course issued the now-widely-known decision in *Southwestern Illinois Development Authority v. National City Environmental*, 768 N.E.2d 1 (Ill. 2002). The court rejected an attempt by the Southwestern Illinois Development Authority (SWIDA) to condemn land for extra parking for the Gateway racetrack next door. The court explained that SWIDA presented "extensive testimony that expanding Gateway's facilities … would allow it to grow and prosper and contribute to positive economic growth in the region. However, incidentally, every lawful business does this." *Id*. at 9 (internal quotation omitted). The court acknowledged that the expansion of Gateway "could potentially trickle down and bring corresponding revenue increases to the region". But, the court held, "revenue expansion alone does not justify an improper and unacceptable expansion of the eminent domain power." *Id*. at 10-11. It found the condemnation lacked a public use.

Other courts this year sounded warning notes about redevelopment authorities' overzealous pursuit of condemnation actions. The Connecticut Supreme Court rejected two proposed condemnations in 2002. While both cases were decided on statutory grounds, the court's comments indicate a growing skepticism about the use of eminent domain, particularly for the benefit of private parties. In *Aposporos v. Urban Redev. Commission*, 259 Conn. 563, 565-68 (Conn. 2002), the court rejected an attempt to expand an older blight designation to allow condemnation of a local diner for additional commercial development. The original blight designation dated from 1963. In 1988, the city amended the plan to include additional property for a new project that would compete with a mall that had been constructed in another part of Stamford in the 1980s. The 1963 redevelopment plan was due to expire in 1993, but the city extended it to 2000. 259 Conn. at 565-68. The city finally began condemnations in the new area at the end of 1999. The Connecticut Supreme Court held that a new finding of blight was required when new property was added to the project area or when the agency sought to conduct a new project, not originally contemplated. To hold otherwise, the Court found, "would confer on redevelopment agencies an unrestricted and unreviewable power to condemn properties for purposes not authorized by the enabling statute and to convert redevelopment areas into their perpetual fiefdoms." Id. at 577.

Similarly, in *Pequonnock Yacht Club, Inc. v. City of Bridgeport*, 259 Conn. 592 (2002), the court found that the condemnation of a yacht club for private development was not essential to the redevelopment plan. However, in deciding that Bridgeport had not shown the necessity of the condemnation, the Court commented that "[t]he city provided no specific reasons [that the condemnation was necessary], other than to enhance desirability of the area to investors." *Id*. at 605. The Court agreed with the trial court that "just because the property may be desirable to the defendants does not justify its taking by eminent domain." *Id*. at 606. These comments indicate that agencies cannot rely upon total deference by the courts any more.

And while also a statutory decision, the Seventh Circuit's decision in *Daniels v. Area Plan Comm'n*, 306 F.3d 445 (7th Cir. 2002), held that, without a legislative declaration of public use, condemnation of property purely for private commercial development did not constitute a public use. The court left open the question of whether that would be a sufficient reason for eminent domain with a legislative declaration. One of the most interesting aspects of the decision was the court's explanation that because the public benefits of the condemnation would occur only as a result of the private business success of the commercial development, the public benefits were *incidental*, rather than primary. *Id*. at 462. This holding is important because so many states find that public benefits must be more than incidental in order to support a condemnation.

An appellate decision out of California put limits on the use of eminent domain for economic development projects. In *Graber v. City of Upland*, 121 Cal. Rptr. 2d 649 (Cal. App. 2002), the appellate court agreed with the trial court that designation of a redevelopment area was improper. It illegally combined two other areas, and the designation of the area as blighted was not supported by substantial evidence. The city attempted to rely on such characteristics as fading or

peeling paint or sagging screens in finding the area blighted. *Id*. at 440-41.

And a federal court in California granted a preliminary injunction against the condemnation of church property for a Costco, as part of an economic development plan. *See Cottonwood Christian Center v. Cypress Redev. Agency*, 218 F. Supp. 2d 1203 (C.D. Cal. 2002). Much of the opinion centered on the Religious Land Use and Institutionalized Persons Act. However, the court also followed last year's decision that the city of Lancaster could not condemn a 99 Cents Store in order to turn the property over to Costco, its competitor. *See 99 Cents Only Stores v. Lancaster Redev. Agency*, 2001 U.S. Dist. Lexis 9894 (C.D. Cal. June 26, 2001). The *Cottonwood* court held that it appeared that defendants had found "a potential user for property they did not own, and then design[ed] a development plan around that new user." Because that was not consistent with the constitutional public use requirement, the court held that, at the preliminary injunction stage, the church demonstrated a substantial likelihood of success on its claim that the condemnations lacked a public use. *Cottonwood*, 218 F. Supp. 2d at 1229-1230.

One trial court case in Connecticut enjoined 11 out of 15 condemnations in an economic development project. While the condemnor knew that four of the homes would be turned into an office building, it had no idea what the other 11 homes would be used for. The court held that eminent domain for economic development could be a public purpose, even without the elimination of blight, and upheld the condemnation of the four homes for the office building. But the court said that property could not be condemned when the condemnor did not know what it was going to do with the property in an economic development project. Under those circumstances, the court could not evaluate whether the property was necessary for the eventual use, since the condemnor did not know the use. It was also impossible to determine if there were assurances of future public use, because, again, no one knew the future use, so the court could not say if it was public or not. *See Kelo v. City of New London*, 2002 Conn. Super. Lexis 789 (Conn. Super. March 13, 2002). The trial court stayed the effect of its decision while the case went up on appeal. It is now at the Connecticut Supreme Court.

In the rubber stamp category, the prize, as usual, goes to New York, which upheld the condemnation of several businesses for a new building for the *New York Times*. The project area is more than 20 years old, and an office building for the *Times* was of course not part of the original plan. The current plan gives the *New York Times* and a private development partner a sharp discount over the market rates for office space in New York. Many of the owners challenged the taking, which New York's Appellate Division upheld in the most cursory fashion. *West 41st Street Realty v. New York State Urban Dev. Corp.*, 744 N.Y.S.2d 122 (N.Y. App. Div. 2002). New York's highest court, the Court of Appeals, denied review on the grounds that there was no substantial constitutional question. 2002 NY Lexis 2384 (N.Y. Sept. 12, 2002). Now, at least one owner has petitioned for certiorari from the Supreme Court. Meanwhile, another court in New York issued a one paragraph opinion upholding another condemnation for "creation of the economic development stimulus to influence the redevelopment of the central business district." *Bendo v. Jamestown Urban Renewal Agency*, 738 N.Y.S.2d 615, 616 (App. Div. 2002). Still, there's always hope for New York in 2004.

Overall then, 2002 saw a number of cases restricting the ability of municipalities to condemn property for transfer to private business interests. The caselaw also saw a continuation of the trend of requiring much stricter procedural and statutory compliance in eminent domain proceedings. Redevelopment agencies should take heed of this sea change. As the Connecticut Supreme Court commented, redevelopment areas are not the agencies "perpetual fiefdom."

* Dana Berliner is a Senior Attorney at the Institute for Justice.

Federalism & Separation of Powers

The Establishment Clause, Federalism and the States

*By John Eastman**

Introduction

At the conclusion of its 2001-2002 term, the Supreme Court issued its opinion in *Zelman v. Simmons-Harris*,[1] a 5-4 decision that rejected an Establishment Clause challenge to the Cleveland, Ohio, school voucher program. Chief Justice Rehnquist's majority opinion was straightforward, describing the decision as compatible with "an unbroken line of decisions rejecting challenges to similar programs."[2] Justice Thomas' concurring opinion, however, was more far-reaching, questioning "as a matter of first principles . . . . [w]hether and how [the Establishment] Clause should constrain state action under the Fourteenth Amendment."[3]

The Establishment Clause, Justice Thomas noted, "originally protected States, and by extension their citizens, from the imposition of an established religion by the Federal Government."[4] When the Fourteenth Amendment was adopted, it "fundamentally restructured the relationship between individuals and the States," giving further protection to individual liberty.[5] Accordingly, incorporation of Establishment Clause rights against the States through the Fourteenth Amendment "should advance, not constrain, individual liberty. . . . [and] it may well be that state action should be evaluated on different terms than similar action by the Federal Government."[6] The states, Justice Thomas noted, "'should be freer to experiment with involvement [in religion]—on a neutral basis—than the Federal Government.'"[7] Justice Thomas concluded, "There would be a tragic irony in converting the Fourteenth Amendment's guarantee of individual liberty into a prohibition on the exercise of educational choice."[8]

Justice Thomas' concurrence reflects a view of the Constitution that is in line with the beliefs of our nation's founding generation. The Founders repeatedly emphasized the importance of education, including a moral education, in a free republic. Only a virtuous people, they believed, could govern themselves, and the Founders thought it would be folly to expect to foster moral virtue throughout the entire citizenry without at least some recourse to religion. The Founders would therefore not have seen the Establishment Clause as an obstacle to a school voucher program. Instead, they would have valued the improved educational opportunities being offered to children and applauded any incidental benefit to religion that resulted. In evaluating a program such as the Cleveland Scholarship Program, the Founders would also have given weight to the differences between the federal government, a government of limited and enumerated powers, and the state governments, to which all other powers are reserved, including the power to regulate the health, safety, welfare, *and morals* of the people.

I. Moral Instruction: Crucial in a Republic

America's founders believed that the education of children was vital to keeping America a free and functioning society. "If a nation expects to be ignorant and free," said Thomas Jefferson, "it expects what never was and never will be."[9] James Madison agreed:

> A popular Government, without popular information, or the means of acquiring it, is but a Prologue to a Farce or a Tragedy; or, perhaps both. Knowledge will forever govern ignorance: And a people who mean to be their own Governors, must arm themselves with the power which knowledge gives.[10]

But by "education," the Founders did not merely mean the dissemination of the facts of science or history; they meant also the inculcation of moral character. Following Montesquieu's well-known admonition that education in a republic, unlike that in a despotism or a monarchy, must necessarily be designed to inculcate virtue in the citizenry,[11] our nation's Founders repeatedly acknowledged the role that moral virtue had to play if their experiment in self-government was to be successful. The Declaration of Rights affixed to the beginning of the Virginia Constitution of 1776, for example, provides "[t]hat no free government, or the blessings of liberty, can be preserved to any people, but by a firm adherence to justice, moderation, temperance, frugality, and virtue, and by frequent recurrence to fundamental principles."[12] The Massachusetts Constitution of 1780 echoes the sentiment: "the happiness of a people, and the good order and preservation of civil government, essentially depend upon piety, religion, and morality."[13]

But perhaps the clearest example of the Founders' views was penned by James Madison, writing as Publius in the 55th number of *The Federalist Papers*:

> Republican government presupposes the existence of [virtue] in a higher degree than any other form. Were [people as depraved as some opponents of the Constitution say they are], the inference would be that there is not sufficient virtue among men for self-government; and that nothing less than the chains of despotism can restrain them from destroying and devouring one another.[14]

In short, the Founders viewed a virtuous citizenry as an essential pre-condition of republican self-government. They were also fully cognizant of the fact that virtue must be continually fostered in order for republican institutions, once established, to survive. Many of the leading Founders, therefore, proposed plans for educational systems that would help foster the kind of moral virtue they thought necessary for self-government.

Perhaps the best example of this sentiment is expressed in the Northwest Ordinance, adopted by Congress in 1787 for the government of the territories: "Religion, morality, and knowledge, being necessary to good government and the happiness of mankind, schools and the means of education shall forever be encouraged."[15] Even Thomas Jefferson, who coined the phrase "a wall of separation between church and State,"[16] provided in his famous proposal for a public education system in Virginia that "[t]he first elements of morality" were to be instilled into students' minds.[17]

As the Northwest Ordinance makes clear, the fostering of moral excellence was, for the Founders, a task intimately tied to religion. President Washington, for example, noted in his Farewell Address that "reason and experience both forbid us to expect that National morality can prevail in exclusion of religious principle."[18] Benjamin Rush was even more blunt: "[W]here there is no religion, there will be no morals."[19] Accordingly, he proposed a public school system whose curriculum included religious instruction, noting that such an education would make "dutiful children, teachable scholars, and, afterwards, good apprentices, good husbands, good wives, honest mechanics, industrious farmers, peaceable sailors, and, in everything that relates to this country, good citizens."[20]

In addition, several of the States explicitly provided for religious education in their State constitutions. The Pennsylvania Constitution of 1776, for example, provided that "all religious societies or bodies of men heretofore united or incorporated for the advancement of religion or learning . . . shall be encouraged and protected."[21] The Massachusetts Constitution of 1780 and the New Hampshire Constitution of 1784 went even further. The Massachusetts Constitution provides:

> The people of this Commonwealth have the right to invest their legislature with power to authorize and require . . . the several towns . . . or religious societies to make suitable provision, at their own expense, . . . for the support and maintenance of public protestant teachers of piety, religion and morality.[22]

And New Hampshire's Constitution authorized the legislature to empower the "several towns . . . to make adequate provision at their own expense for the support and maintenance of public protestant teachers of piety, religion and morality" because "morality and piety . . . will give the best and greatest security to government." [23]

While no State has, since the 1830s, supported such a starkly sectarian establishment of religion as is evident in the Massachusetts and New Hampshire Constitutions' references to "protestant teachers," several continue to recognize the importance of moral-religious instruction in fostering the kind of citizen virtue the Founders thought necessary to the continued security of the republic.[24]

Particularly where individual parents remain free to direct the state's tuition support to schools of their own choosing, any incidental benefit to religion would have been viewed by the Founders as an added benefit, not a constitutional impediment. Benjamin Rush addressed this point in his proposal for a public education system: "[T]he children of parents of the same religious denominations should be educated together," he wrote, "in order that they may be instructed with the more ease in the principles and forms of their respective churches."[25] "If each society in this manner takes care of its own youth," he noted, "the whole republic must soon be well educated."[26]

Given the Founders' views on the subject, it would be extraordinary to conclude that the Constitution they drafted and ratified mandates the *exclusion* of religious schools from a general tuition support program. Indeed, from the Founders' vantage point, such a holding would have been viewed as dangerous, because it thwarts rather than supports the very kind of moral-religious education that they thought so necessary to the preservation of free government.[27]

II. The Establishment Clause and Federalism

A. Education, a Core Function of State and Local Governments

The Supreme Court has often acknowledged that the Constitution creates a federal government of limited and enumerated powers, with the bulk of powers reserved to the states or to the people.[28] As James Madison explained:

> The powers delegated by the proposed Constitution to the Federal Government, are few and defined. Those which are to remain in the State Governments are numerous and indefinite. The former will be exercised principally on external objects . . . . The powers reserved to the several States will extend to all the objects, which, in the ordinary course of affairs, concern the lives, liberties and properties of the people; and the internal order, improvement, and prosperity of the State.[29]

Education is among the most important of those duties not delegated to the federal government but reserved to the states or to the people, and as the discussion in Part I above demonstrates, moral instruction, especially the kind of moral instruction fostered by religion, has for most of our nation's history been viewed as an essential component of that core state function. Thus, any proper interpretation of the Establishment Clause—at least as it applies to the states—simply must recognize the important place religion has always played in state efforts to undertake this core police power.

B. Regulating the Morals of the People, A Core State Police Power

It has long been settled that the First Amendment (like the other provisions of the Bill of Rights) was originally intended to apply only to the federal government, not to the state governments. "*Congress* shall make no law . . . ." meant precisely that.[30] This is particularly true with respect to the Establishment Clause, whose language, "Congress shall pass no law *respecting* the establishment of religion," was designed with a two-fold purpose: to prevent the federal government from establishing a national church; and to prevent the federal government from interfering with the state estab-

lished churches and other state aid to religion that existed at the time.[31]

Of course, the Fourteenth Amendment affected a fundamental change in our constitutional order and was intended to afford individuals federal protection against state governments that would interfere with their fundamental rights. But the Establishment Clause is on its face different in kind than the other provisions of the Bill of Rights that had previously been incorporated and made applicable to the states via the Fourteenth Amendment. The Free Speech and Free Exercise Clauses, for example, are much more readily described as protecting a "liberty" interest or a "privilege" of citizenship than is the Establishment Clause, yet when the Supreme Court in *Everson v. Board of Education*[32] held that the Establishment Clause was incorporated and made applicable to the States via the Due Process clause of the Fourteenth Amendment, it merely cited its prior cases incorporating the Free Speech and Free Exercise clauses, without any analysis of the evident differences between them and the Establishment Clause.[33]

Moreover, the application of the Establishment Clause to the states has allowed the federal courts and the Congress, via Section Five of the Fourteenth Amendment, to do the very thing the clause was arguably designed to prevent, namely, interfere with state support of religion. Indeed, the constitutional prohibition on federal intrusion into this area of core state sovereignty is much more explicit than the prohibition on federal commandeering of state officials,[34] the limits of federal power inherent in the doctrine of enumerated powers,[35] or even the barrier to federal power erected by the doctrine of state sovereign immunity the Supreme Court has held to be implicit in the Eleventh Amendment.[36] Yet in each of these latter areas, the Supreme Court has in recent years given renewed attention to the limits of federal power.

One need not revisit the long-standing precedent incorporating the Establishment Clause in order to give due consideration to federalism concerns; the scope of activity prohibited by the Establishment Clause, as incorporated, may well be narrower with respect to the States than with respect to the federal government. Such a distinction is particularly important in light of the fact that the states rather than the federal government have historically been viewed as the repository of the police power—that power to regulate the health, safety, welfare, *and morals* of the people.[37] Thus, even if a "no aid to any or all religions, directly or indirectly," rule were an appropriate interpretation of the Establishment Clause vis-à-vis the federal government, the application of such a rule in the incorporated Establishment Clause context intrudes upon core areas of state sovereignty in a way that simply finds no support in either the text or theory of the Fourteenth Amendment.

Conclusion

The Founders valued moral teaching, viewing it as indispensable in a free republic. They knew that a people without virtue would be unable to govern themselves, and the school systems that they established during their time reflected this belief. They would have been surprised at modern arguments that the Establishment Clause should prohibit the use of a school voucher program because of an incidental benefit to religion, the institution that has been among the most successful at fostering moral virtue. The Founders' views that a school voucher program is constitutionally sustainable would have been further supported by their recognition that the republic they created is federalist in nature. Limits placed upon the federal government cannot necessarily be directly translated against the state governments, to which all "powers not delegated to the United States by the Constitution" have been entrusted.[38]

In *Zelman*, the Supreme Court reached a decision that was certainly compatible with its line of Establishment Clause decisions restricting actions that the *federal* government may take; however, the decision would have been justified in reaching even further, as Justice Thomas' concurrence did. The tests for state and federal action should not be identical. States should be "'freer to experiment with involvement [in religion].'"[39] As the court evaluates such state action, it "can strike a proper balance between the demands of the Fourteenth Amendment on the one hand and the federalism prerogatives of States on the other."[40] As Justice Thomas concluded, failing to do so could result in a "tragic irony" if the "Fourteenth Amendment's guarantee of individual liberty [were to become] a prohibition on the exercise of educational choice."[41]

* John Eastman is a Professor of Law at the Chapman University School of Law and Director of the Claremont Institute Center for Constitutional Jurisprudence. This essay was adapted from an amicus brief filed in *Zelman v. Simmons-Harris* by the Claremont Institute Center for Constitutional Jurisprudence. The assistance of then-Chapman Law School student Timothy Sandefur on the brief, and Tara Ross on this essay, is gratefully acknowledged.

Footnotes

1. 122 S. Ct. 2460 (2002).
2. *Id.* at 2473.
3. *Id.* at 2480-81 (Thomas, J., concurring).
4. *Id.* at 2481.
5. *Id.*
6. *Id.*
7. *Id.* (quoting Walz v. Tax Comm'n of N.Y., 397 U.S. 664, 699 (1970) (Harlan, J., concurring)).
8. *Id.* at 2482.
9. Letter from Thomas Jefferson to Colonel Charles Yancey (Jan. 6, 1816), *in* 11 The Works of Thomas Jefferson 493, 497 (Paul Leicester Ford ed., federal ed. 1905).
10. Letter from James Madison to William T. Barry (Aug. 4, 1822), *in* James Madison: Writings 790, 790 (Jack N. Rakove ed., 1999).
11. *See* Charles de Secondat, Baron de Montesquieu, The Spirit of Laws (1748), *reprinted in* 38 Great Books of the Western World 1, 13, 15 (Thomas Nugent trans., Robert Maynard Hutchins et al. eds., Encyclopaedia Britannica, Inc. 1952).
12. Va. Const. of 1776, Bill of Rights, § 15.

13. Mass. Const. of 1780, pt. 1, art. III.

14. The Federalist No. 55, at 378 (James Madison) (Jacob E. Cooke ed., 1961).

15. An Ordinance for the Government of the Territory of the United States Northwest of the River Ohio, Art. 3, 1 Stat. 51, 53 n.a (July 13, 1787, re-enacted Aug. 7, 1789); *see also*, *e.g.*, Mass. Const. of 1780, pt. 2, ch. V, § 2 ("Wisdom and knowledge, as well as virtue, diffused generally among the body of the people [are] necessary for the preservation of their rights and liberties.").

16. Letter to Messrs. Nehemiah Dodge and Others, a Committee of the Danbury Baptist Association, in the State of Connecticut (Jan. 1, 1802), *in* Thomas Jefferson: Writings 510, 510 (Merrill D. Peterson ed., 1984).

17. Thomas Jefferson, Notes on the State of Virginia (1785), *reprinted in* Thomas Jefferson: Writings 123, 273 (Merrill D. Peterson ed., 1984).

18. George Washington, Farewell Address (Sept. 19, 1796), *reprinted in* George Washington: A Collection 512, 521 (W.B. Allen ed., 1988).

19. Benjamin Rush, Speech in Pennsylvania Ratifying Convention (Dec. 12, 1787), *reprinted in* 2 The Documentary History of the Ratification of the Constitution 594, 595 (Merrill Jensen ed., 1976).

20. Benjamin Rush, To the Citizens of Philadelphia: A Plan for Free Schools (Mar. 28, 1787), *reprinted in* 1 Letters of Benjamin Rush 412, 414 (L.H. Butterfield ed., 1951) [hereinafter Rush, To the Citizens of Philadelphia].

21. Pa. Const. of 1776, § 45; *see also* Vt. Const. of 1777, ch. II, § XLI ("[A]ll religious societies or bodies of men that have or may be hereafter united and incorporated, for the advancement of religion and learning . . . shall be encouraged and protected.").

22. Mass. Const. of 1780, pt. I, art. III.

23. N.H. Const. of 1784, pt. I, § 6.

24. *See, e.g.*, Neb. Const. art. 1, § 4 ("Religion, morality, and knowledge, however, being essential to good government, it shall be the duty of the Legislature . . . to encourage schools and the means of instruction."); Vt. Const. ch. II, § 68; Ind. Const. art. 8, § 1; Iowa Const. art. IX, § 3; *see also* Mass. Gen. Laws ch. 71, § 30 (2001) (providing that it is the duty of Harvard professors and other teachers of youth "to impress on the minds of children and youth committed to their care and instruction the principles of *piety* and justice") (emphasis added).

25. Rush, To the Citizens of Philadelphia, *supra* note 20, at 414.

26. Benjamin Rush, To The Citizens of Pennsylvania of German Birth and Extraction: Proposal of a German College, *reprinted in* 1 Letters of Benjamin Rush, *supra* note 20, at 364, 364.

27. *Cf.* Martin Luther King, Jr., The Words of Martin Luther King, Jr. 41 (Coretta Scott King ed., 1983) ("[E]ducation which stops with efficiency may prove the greatest menace to society. The most dangerous criminal may be the man gifted with reason but with no morals. We must remember that intelligence is not enough. Intelligence plus character—that is the goal of true education.").

28. *See, e.g.*, United States v. Lopez, 514 U.S. 549, 552 (1995); U.S. Const. amend. X.

29. The Federalist No. 45, at 313 (James Madison) (Jacob E. Cooke ed., 1961).

30. U.S. Const. amend. I (emphasis added); *see also* Barron v. Mayor & City Council of Baltimore, 32 U.S. (7 Pet.) 243 (1833); Permoli v. Municipality No. 1 of New Orleans, 44 U.S. (3 How.) 589 (1845) (holding the Free Exercise clause inapplicable to the states).

31. *See, e.g.*, School Dist. of Abington Township v. Schempp, 374 U.S. 203, 309-310 (1963) (Stewart, J., dissenting); Constitutional Law 1418 (G. Stone et al. eds., 4th ed. 2001) (citing W. Katz, Religion and American Constitutions 8-10 (1964)); *see also* Neil H. Cogan, The Complete Bill of Rights 1-8, 53-62 (1997) (reprinting the debates in Congress leading to the proposal of the First Amendment's religion clauses).

32. 330 U.S. 1 (1947).

33. *See id*. at 8 (citing *Murdock v. Pennsylvania*, 319 U.S. 105 (1943), a free exercise case); *id*. at 15 (citing *Cantwell v. Connecticut*, 310 U.S. 296 (1940), a free exercise case, which in turn relied upon *Schneider v. State*, 308 U.S. 147 (1939), a free speech case).

34. *See* New York v. United States, 505 U.S. 144 (1992).

35. *See* United States v. Lopez, 514 U.S. 549 (1995).

36. *See* Seminole Tribe of Fla. v. Florida, 517 U.S. 44 (1996).

37. *See, e.g.,* Barnes v. Glen Theatre, Inc.; 501 U.S. 560, 569 (1991); New State Ice Co. v. Liebmann, 285 U.S. 262, 304 (1932).

38. U.S. Const. amend X ("The powers not delegated to the United States by the Constitution, nor prohibited by it to the states, are reserved to the states respectively, or to the people.").

39. Zelman v. Simmons-Harris, 122 S. Ct. 2460, 2481 (2002) (Thomas, J., concurring) (quoting Walz v. Tax Comm'n of N.Y., 397 U. S. 664, 699 (1970) (Harlan, J., concurring)).

40. *Id.*

41. *Id.* at 2482.

Can a Man Head the Women's Bureau at the Department of Labor?

The Unconstitutionality of Congressional Class Limitations on Presidential Nominations

*By Donald J. Kochan**

Introduction

Can a man become the Director of the Women's Bureau at the Department of Labor? According to Congress, the answer is no. In 1920, as the States were ratifying the Nineteenth Amendment to guarantee nondiscriminatory suffrage, Congress created the Women's Bureau. Ironically, in establishing the position of its Director, Congress *discriminated on the basis of sex*—requiring that the Director be "*a woman* . . . appointed by the President, by and with the advice and consent of the Senate."[1] Policy concerns regarding equal protection may themselves justify voiding this 80-year old quota; however, this essay raises a more fundamental issue regarding the constitutional separation of powers: whether Congress may, by statute, limit the class of persons the President may nominate under his Appointments Clause power.

Whether a woman *should* be appointed to head the Women's Bureau is outside the scope of this essay. There are probably many compelling policy reasons why a President would choose to appoint a woman to direct the Bureau, but the question of this essay is whether Congress may constitutionally remove the President's discretion to choose his nominees, regardless of their sex, racial class, or other characteristics.

Although the Senate may refuse its advice and consent to anyone named by the President, the Constitution clearly prohibits Congress from placing restrictions on who the President may present to the Senate for appointment. This essay uses the Women's Bureau statute as a case study for the examination of this conclusion

I. The Women's Bureau and the Appointment of Its Director

According to its website, "the Women's Bureau is the single unit at the Federal government level exclusively concerned with serving and promoting the interests of working women."[2] The provision for the appointment of the Director of the Women's Bureau provides that "[t]he Women's Bureau shall be in charge of a director, a woman, to be appointed by the President, by and with the advice and consent of the Senate."[3]

By its plain terms, this provision creates the Director position but precludes the President from appointing a male to run the Women's Bureau.[4] It disqualifies all men from holding the position. And, as one would expect from that text, there have been fifteen Directors, all women, since the Bureau was created in 1920.[5]

II. The Appointments Clause and An Unconstitutional Intrusion on Presidential Powers By the Senate

"[W]ith admirable clarity,"[6] the text of the Appointments Clause bifurcates the roles of the President and Senate and vests the choice of a nominee for a position as an Officer of the United States solely with the President. The Appointments Clause of the Constitution provides that the President

> shall nominate, and by and with the Advice and Consent of the Senate, shall appoint Ambassadors, other public Ministers and Consuls, Judges of the supreme Court, and all other Officers of the United States, whose Appointments are not herein otherwise provided for, and which shall be established by Law: but the Congress may by Law vest the Appointment of such inferior Officers, as they think proper, in the President alone, in the Courts of Law, or in the Heads of Departments.[7]

The text is clear—the Senate and the President have separate and distinct, yet interdependent roles in the appointment of Officers.

Moreover, the Framers knew how to limit the President's nomination power when they wanted to do so. A second argument for concluding that the President has discretion in choosing a nominee for an Officer derives from a time-honored principle of statutory construction, *expressio unius est exclusio alterius*—the expression of one is the exclusion of others. The Constitution itself creates one limit on the President's power to choose a nominee in the Emoluments and Incompatibility Clauses. They state:

> No Senator or Representative shall, during the Time for which he was elected, be appointed to any civil Office under the Authority of the United States, which shall have been created, or the Emoluments whereof shall have been encreased during such time; and no Person holding any Office under the United States, shall be a Member of either House during his Continuance in Office.[8]

This enumeration of one limitation on the class of eligible nominees as Officers of the United States excludes the presumption that any other limitations exist on the President's choice in making nominations.[9]

Substantial history from the drafting of the Appointments Clause indicates that the President was not to be constrained in his choice of persons to nominate—just as the Senate could, constitutionally, reject any nominee without constraint. Alexander Hamilton explained in *Federalist No. 66* that the Senate has no role in restricting the President's choice of nominees for an Officer position created by Congress:

> It will be the office of the president to *nominate*, and with the advice and consent of the senate to *appoint*. There will of course be no exertion of *choice* on the part of the senate. They may defeat one choice of the executive, and oblige him to make another; but they cannot themselves *choose*—they can only ratify or reject the choice, of the president.[10]

The Senate could defeat every man that the President might nominate as an Officer, including every man nominated to become director of the Women's Bureau, but they cannot invade the province of the Executive by statutorily prohibiting the nomination of a man. As Professor John Yoo has stated, "[w]hile the Senate may reject nominees . . . it is quite clear that the Senate cannot choose them, contrary to suggestions made by some scholars."[11] Similarly, Senators could informally express their view that a woman should be appointed for a position, but they cannot statutorily require it.

By placing class restrictions in a statute authorizing an Officer position, the Senate is unconstitutionally exerting the type of choice that Hamilton explained was prohibited. In *Federalist* No. 76, Hamilton continued:

> In the act of nomination [the President's] judgment alone would be exercised; and as it would be his sole duty to point out the man, who with the approbation of the Senate should fill an office, his responsibility would be as complete as if he were to make the final appointment. . . . [E]very man who might be appointed would be in fact his choice.
>
> But might not [the President's] nomination be overruled? I grant it might, yet this could only be to make place for another nomination by [the President]. The person ultimately appointed must be the object of his preference, though perhaps not in the first degree.[12]

The President must have full control of, and accountability for, his exercise of the nomination power granted to him in the Constitution. Statutes such as the one creating the Director of the Women's Bureau unconstitutionally trespass upon the President's exercise of that power.[13]

III. An Unconstitutional Intrusion by the House of Representatives and Ex-Presidents

Another troubling separation-of-powers concern that arises from congressional limitations on the pool of Officer nominees results from the intrusion of the House of Representatives and past Presidents into the purely senatorial function of "Advice and Consent."[14] Establishing an Office "by Law"[15] requires a bicameral act and presentment to the President. Therefore, the Appointments Clause clearly contemplates the act of bicameralism and presentment in the *creation of an Office*. In contrast, *Advice and Consent* is clearly limited to only one entity—the Senate.

By allowing Congress, as a whole, to place limitations on the President's choice of a nominee for an Office, the House of Representatives intrudes upon senatorial prerogative by itself engaging in pre-nomination advice. Even if the Senate could be said to have some role in offering pre-nomination advice,[16] certainly the House does not. Duties committed solely to one house of Congress cannot be exercised by the other. For example, the Origination Clause, which requires that all bills for raising revenue must originate in the House of Representatives, makes invalid any bills for raising revenue that originate in the Senate.[17] The Appointments Clause similarly limits the advice and consent function to the Senate and provides no room for formal House involvement.

The same is true of the President who signs the legislation creating an Office with a restricted pool of eligible nominees and binds, therefore, future Presidents to that nomination restriction. It is the sole power of the President that actually makes the appointment to choose his nominee, and a prior President can have no role in limiting that future President's class of potential nominees.

Conclusion

Even absent the statutory restriction, one might expect that the position of Director of the Women's Bureau has been, and likely always will be, filled by a woman. But, far from being "harmless error," the Women's Bureau appointment provision reflects a fundamental encroachment on presidential prerogatives established in the Constitution, sets poor precedent, and should be amended by Congress.[18] As the concurring Justices of the Supreme Court concluded in *Public Citizen*, "where the Constitution by explicit text commits the power at issue to the exclusive control of the President, we have refused to tolerate *any* intrusion by the Legislative Branch."[19] It should not be tolerated for the appointment of the Director of the Women's Bureau.

The invalidity of the Women's Bureau statute has implications beyond just the Department of Labor. Just imagine the havoc Congress might try to wreak if it believed it had the power to broadly restrict presidential nominations to certain sexes or other classes of persons. Admittedly, this is not the only instance where Congress has tried to limit the pool of prospective nominees by statute or placed "qualification" requirements in appointment statutes,[20] and other situations should also be addressed.

Congress should take action to remove this restriction from the Women's Bureau statute and any similar laws that run afoul of the Constitution's limitation on the congressional role in the appointments process. Not only is it Congress's constitutional obligation, but it would also provide an opportunity to underscore an important principle regarding the separation of powers.

Because political pressures and policy reasons will likely compel future Presidents to nominate a woman to head the Women's Bureau, the probable policy supporting the Sixty-Sixth Congress's decision to create the unconstitutional mandate—ensuring that a female runs the Bureau—is likely to go undisturbed by an amendment removing the gender restriction from the appointments provision. As Hamilton wisely observed, placing the sole power of nomination in the hands of the President will also constrain him, for "[t]he possibility of rejection would be a strong motive to care in proposing."[21] The policy objective can be achieved while cleansing the statute of its constitutional infirmities.

* Donald J. Kochan is an Assistant Professor of Law at George Mason University School of Law. He holds his J.D. (1998) from Cornell Law School and his B.A. (1995) from Western Michigan University.

Footnotes

1. 29 U.S.C. § 12 (2000) (emphasis added). The Director appointment provision was first passed in the statute establishing the Women's Bureau, and it has never been amended. *See* Pub. L. No. 66-259, 41 Stat. 987 (June 5, 1920).

2. Women's Bureau, U.S. Dep't of Labor, The Women's Bureau: An Overview, *at* http://www.dol.gov/wb/info_about_wb/interwb2.htm (last visited Dec. 2, 2002); *see also* 29 U.S.C. § 13 (2000) (setting out the statutory powers and duties of the Women's Bureau).

3. 29 U.S.C. § 12.

4. Interestingly, Congress placed no gender restriction on the Assistant Director of the Women's Bureau, an inferior position filled through appointment by the Secretary of Labor. *See* 29 U.S.C. § 14 (2000).

5. Women's Bureau, U.S. Dep't of Labor, Director's Gallery, *at* http://www.dol.gov/wb/edu/gallery.htm (last visited Dec. 2, 2002).

6. Pub. Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 487 (1989) (Kennedy, J., concurring) ("The President's power to nominate principal officers falls within the line of cases in which a balancing approach is inapplicable. . . . The President has the sole responsibility for nominating these officials, and the Senate has the sole responsibility of consenting to the President's choice.").

7. U.S. Const. art II, § 2, cl. 2.

8. U.S. Const. art. I, § 6, cl. 2.

9. *See Pub. Citizen*, 491 U.S. at 484 (Kennedy, J., concurring) (making a similar argument).

10. The Federalist No. 66, at 449 (Jacob E. Cooke ed. 1961).

11. John C. Yoo, *Criticizing Judges*, 1 Green Bag 2d 277, 284 (1998).

12. The Federalist No. 76, at 512 (Jacob E. Cooke ed. 1961).

13. It is worthwhile to note that another set of commentators reached a similar conclusion in relation to statutory limitations on nominees in the Anti-Nepotism Statute, 5 U.S.C. § 3110 (precluding the nomination of a relative), the Solicitor General Statute, 28 U.S.C. § 505 (requiring that the Solicitor General be "learned in the law"), and the Federal Communications Commission authorizing statute, 47 U.S.C. § 154 (restricting the number of commissioners who may be of the same political party). *See* Richard P. Wulwick & Frank J. Macchiarola, *Congressional Interference with the President's Power to Appoint*, 24 Stetson L. Rev. 625 (1995).

14. U.S. Const. art II, § 2, cl. 2.

15. *Id*.

16. For an excellent discussion of why the Senate has no constitutional pre-nomination role in advice on judicial candidates, see generally John O. McGinnis, *The President, the Senate, the Constitution, and the Confirmation Process: A Reply to Professors Strauss and Sunstein*, 71 Tex. L. Rev. 633 (1993).

17. *See generally* Flint v. Stone Tracy Co., 220 U.S. 107 (1911) (noting the requirement of the Origination Clause that revenue bills originate in the House); United States v. Munoz-Flores, 863 F.2d 654 (9th Cir. 1988) (same; invalidating law).

18. One might argue that the position itself, as currently constituted, is unconstitutional. Of course, the courts might very well find that the unconstitutional component, the words "a woman," is severable from the remainder of the position. Especially because it is unlikely anyone would ever have standing to challenge the statute, it is Congress's responsibility to correct its error.

19. Pub. Citizen v. U.S. Dep't of Justice, 491 U.S. 440, 485 (1989) (Kennedy, J., concurring); *see also id.* at 487 (noting that the three branches need not be "entirely separate and distinct . . . . [b]ut as to the particular divisions of power that the Constitution does in fact draw, we are without authority to alter them, and indeed we are empowered to act in particular cases to prevent any other Branch from undertaking to alter them.").

20. *See* Wulwick & Macchiarola, *supra* note 13, at 626 & n.5 (listing statutes that attempt to place restrictions on the President's Appointment Clause power). This Author is not, however, aware of any other appointment statutes that create sex or class limitations.

21. The Federalist No. 76, at 513 (Jacob E. Cooke ed. 1961).

Sprietsma v. Mercury Marine:

How Preemption and Administrative Law Intersect

*By Jack Park**

In its recent decision in *Sprietsma v. Mercury Marine*,[1] the United States Supreme Court again entered the swamp of tort preemption.[2] In that swamp, federal statutory or regulatory activities will preempt some, but not all, claims that common-law duties have been tortiously breached. In *Sprietsma*, the Court unanimously concluded that a common-law tort lawsuit related to propeller guards on motorboat engines was not preempted. The next preemption case will involve a different product and a different federal statute, so *Sprietsma* may not dictate its outcome.[3] To the extent that *Sprietsma* turns on the status of a regulatory decision-making exercise under administrative law, however, it implicitly provides a road map to regulators on how to avoid turning the responsibility for making such decisions over to a jury.

Rex Sprietsma sought relief in Illinois state court after his wife died in a boating accident. She had fallen overboard, and Sprietsma alleged that the manufacturer of the boat's outboard motor was negligent in failing to protect the motor with a propeller guard. Boat safety is the subject of at least one federal statute, and a federal agency has considered whether to require that such outboard motors be equipped with propeller guards. Mercury Marine contended that these federal statutory and regulatory activities preempted Sprietsma's claims. The Illinois courts agreed that the claims were preempted, but disagreed on whether the claims were expressly or impliedly preempted. In its decision, the Illinois Supreme Court relied, in part, on the United States Supreme Court's decision in *Geier v. American Honda Motor Co.*,[4] in concluding that Sprietsma's claims were impliedly preempted.[5] The United States Supreme Court unanimously disagreed, holding that Sprietsma's claims were neither expressly nor impliedly preempted.

The Court's decision is noteworthy for its treatment of the implied preemption issue and for its implications for administrative law. Before discussing those issues, this article will first address the issue of express preemption and how the Court's decision on that issue affects its treatment of implied preemption. That initial discussion will set the stage for the implied preemption and regulatory issues.

With respect to express preemption, the Court's decision was largely prefigured in *Geier*. As with the National Traffic and Motor Vehicle Safety Act, which was at issue in *Geier*, the Federal Boat Safety Act includes both a preemption provision[6] and a saving clause.[7] A preemption provision precludes states and localities from imposing standards inconsistent with those mandated by the Federal Government, while a saving clause preserves some claims from preemption. In *Geier*, the Court held that the presence of the saving clause presumed that there were claims to save, and that reading the clause to preserve some claims gave the clause room for operation.[8] In *Sprietsma*, the Court quoted the applicable portion of *Geier* to support the first point,[9] and general rules of statutory construction support the second.[10] Accordingly, neither Sprietsma's common-law claims nor Geier's were expressly preempted by the applicable statute.

Implied preemption may apply even in the absence of express preemption. The Court explained:

> Congress' inclusion of an express pre-emption clause "does *not* bar the ordinary working of conflict pre-emption principles" that find implied preemption "where it is impossible for a private party to comply with both state and federal requirements, or where state law stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[11]

The implied preemption issue in *Sprietsma* turns on the effect of the regulatory activity of the Coast Guard. In the Federal Boat Safety Act, Congress authorized the Secretary of Transportation to issue regulations "establishing minimum safety standards for recreational vessels and associated equipment" and "requiring the installation, carrying, or use of associated equipment."[12] Congress further instructed:

> In prescribing regulations under this section, the Secretary shall, among other things—
>
> (1) consider the need for and the extent to which the regulations will contribute to recreational vessel safety;
>
> (2) consider relevant available recreational vessel safety standards, statistics, and data, including public and private research, development, testing, and evaluation;
>
> (3) not compel substantial alteration of a recreational vessel or item of associated equipment that is in existence, or the construction or manufacture of which is begun before the effective date of the regulation, but subject to that limitation may require compliance or performance, to avoid a substantial risk of personal injury to the public, that the Secretary considers appropriate in relation to the degree of hazard that the compliance will correct; and
>
> (4) consult with the National Boating Safety Advisory Council established under section 13110 of this title about the considerations [listed in this subsection].[13]

Exemptions from the regulations are authorized when the Secretary determines that "recreational vessel safety will not be adversely affected."[14]

In 1988, pursuant to this grant of authority, the Coast Guard asked the Advisory Council to study the feasibility and safety advantages and disadvantages of requiring propeller guards on recreational boats. The Council appointed a Propeller Guard Subcommittee, which, after an 18-month review, recommended that the Coast Guard "'take no regula-

tory action to require propeller guards.'"[15] The Subcommittee found that the number of propeller guard accidents was relatively small and that propeller guards would adversely affect the operation of recreational boats and might create additional and more severe hazards. It concluded:

> "Since there are hundreds of propulsion unit models now in existence, and thousands of hull designs, the possible hull/propulsion unit combinations are extremely high. No simple universal design suitable for all boats and motors in existence has been described or demonstrated to be technologically or economically feasible. To retrofit the some 10 to 15,000,000 existing boats would thus require a vast number of guard models at prohibitive cost."[16]

The Advisory Council adopted the subcommittee's recommendations, and so, in turn, did the Coast Guard. For its part, the Coast Guard explained,

> "The regulatory process is very structured and stringent regarding justification. Available propeller guard accident data do not support imposition of a regulation requiring propeller guards on motorboats. Regulatory action is also limited by the many questions about whether a universally acceptable propeller guard is available or technically feasible in all modes of boat operation. Additionally, the question of retrofitting millions of boats would certainly be a major economic consideration."[17]

Since 1990, the Coast Guard has displayed signs of continued regulatory interest, but has not promulgated regulations. Most recently, in 2001, the Advisory Council recommended that the Coast Guard adopt four specific regulations, two of which involve retrofitting existing boats and two of which involve new boats.[18] In 2001, the Coast Guard proposed "to require owners of non-planing recreational houseboats with propeller-driven propulsion located aft of the transom to install one of two propulsion unit measures or employ three combined measures."[19] In its decision, the Court noted, however, that the Coast Guard has "not yet issued any regulation either requiring or prohibiting propeller guards on recreational *planing* vessels such as the boat involved in this case."[20]

The Court found this record of regulatory attention to be insufficient to impliedly preempt Sprietsma's claims. It explained that the Coast Guard's 1990 decision not to take regulatory action "left the law applicable to propeller guards exactly the same as it had been before the subcommittee began its investigation."[21] The Court then declared that the Coast Guard's action "is fully consistent with an intent to preserve *state regulatory authority* pending the adoption of specific federal standards."[22] It acknowledged: "With regard to policies defined by Congress, we have recognized that 'a federal decision to forgo regulation in a given area may imply an authoritative federal determination that the area is best left *un*regulated, and in that event would have as much pre-emptive force as a decision *to* regulate,'"[23] but characterized the Coast Guard's decision as one that was not of this character. The Court then parsed the Coast Guard's letter, observing:

> [N]othing in its official explanation would be inconsistent with a tort verdict premised on a jury's finding that some type of propeller guard should have been installed on this particular kind of boat equipped with respondent's particular type of motor. Thus, although the Coast Guard's decision not to require propeller guards was undoubtedly intentional and carefully considered, it does not convey an "authoritative" message of a federal policy against propeller guards.[24]

The Court contrasted the holding in *Geier*, where it gave preemptive effect to a Federal Motor Vehicle Safety Standard. In *Geier*, the Court held, in a 5-4 decision over a dissent written by Justice Stevens, that a 1984 Safety Standard allowing auto manufacturers to phase-in their introduction of passive restraint systems, such as airbags, impliedly preempted the defective design claim of a plaintiff injured while driving a 1987 Honda Accord that was not equipped with a driver's side airbag. The Department of Transportation's deliberations regarding the Safety Standard were marked by considerations of practicality, just like the deliberations of the Propeller Guard Subcommittee in *Sprietsma*. For example, the Court noted, "DOT wrote that it had *rejected* a proposed FMVSS 208 'all airbag' standard because of safety concerns (perceived or real) associated with airbags, which concerns threatened a 'backlash' more easily overcome 'if airbags' were 'not the only way of complying.'"[25] In *Sprietsma*, the Court characterized that agency regulatory decision to phase-in airbags as "an affirmative 'policy judgment.'"[26]

In making that characterization, the Court incorporated a quotation from the Solicitor General's Brief in *Geier*. In its *Geier* brief, the United States argued that, while Geier's claims were not expressly preempted, they were impliedly preempted "because a judgment for petitioners would stand as an obstacle to the accomplishment of the full purposes and objectives of the Standard."[27] The Court's minimization of the effect of the work of the Propeller Guard Subcommittee likewise gives substantial weight to arguments made by the Solicitor General in his *Sprietsma* amicus brief.

In its *Sprietsma* Brief, the United States discounted the effect of the 1990 Coast Guard letter in two ways. First, it pointed out that the letter was not an agency action having legal effect in its own right, such as a regulation, rule, or public pronouncement made at the conclusion of either a formal or informal administrative rule-making procedure. Given that the letter had

> none of the . . . indicia of an agency determination that has (or was intended to have) the force of law in its own right, there is no occasion in this case to decide what degree of formality or type of procedure would be necessary in any given context for a particular agency action to have preemptive effect.[28]

Second, the United States suggested that, even if the 1990 Coast Guard letter had the effect of law, the imposition of tort-law liability arising from the failure to install a propeller guard "would not be in conflict with any policy judgment set

forth in the letter."[29] In part, the letter "simply announced the agency's conclusion, given the evidence available at that time, that affirmative imposition of a federal propeller guard requirement could not be justified under the relevant statutory criteria."[30] Moreover, the United States argued tort lawsuits "in an individual case involving a particular type of boat or engine" did not implicate issues of universality or retrofitting.[31] Finally, the agency's bursts of interest were marshaled to show that it had not abandoned the field.

The position taken by the United States makes sense in the arena of administrative law, but still gives too little respect to the Coast Guard's and Propeller Guard Subcommittee's work. Obviously, not every federal agency letter should be treated as agency action. Even so, the effect of *Sprietsma* is to give no weight to what the Court characterizes as an "undoubtedly intentional and carefully considered" decision,[32] albeit a decision not to do something. The difference between this "undoubtedly intentional and carefully considered" decision not to do something and the "affirmative 'policy judgment'" to do something at issue in *Geier* is largely one of degree. A federal agency's "undoubtedly intentional and carefully considered" decision ought to be accorded more weight.

Federal regulators can and should take steps to give their decisions not to act preemptive weight. As the United States hints in its brief, if the Coast Guard's letter had been "a formal public pronouncement issued at the conclusion of a notice-and-comment rulemaking proceeding (and on the basis of the record and comments in that proceeding) stating that no federal safety standard requiring propeller guards would be adopted and that a propeller guard requirement of any sort would undermine boating safety,"[33] that letter might have been given preemptive effect. Clearly, federal regulators can make such pronouncements. Not only that, they should make them. Their carefully considered conclusion that promulgation of a safety standard is not appropriate should get some respect, coming as it would from individuals with experience in the field after serious consideration. The regulators can guarantee that their decisions get respect by cloaking them with the deference given to the administrative process. *Sprietsma* shows that, if the regulators do not protect their decision-making, they risk turning the regulatory decision over to a jury convened to hear a particular case.

As noted above, the Court followed the Solicitor's lead in minimizing the effect of the Coast Guard's letter. The Court concluded by rejecting a plea for uniform standards, explaining:

> [T]his interest [in uniformity in manufacturing regulations] is not unyielding, as is demonstrated both by the Coast Guard's early grants of broad exemptions for state regulations and by the position it has taken in this litigation. Absent a contrary decision by the Coast Guard, the concern with uniformity does not justify the displacement of state common-law remedies that compensate accident victims and their families and that serve the Act's more prominent objective, emphasized by its title, of promoting boating safety.[34]

With that, the Court turned the issue of propeller guard safety over to, among others, the Illinois state courts. A state-court judgment holding Mercury Marine liable for failing to install a propeller guard or other safety feature on Sprietsma's boat would affect not only the interests of Mercury Marine, but also the interests of all manufacturers of such boats and motors. Furthermore, contrary to the expectation of the Court and the United States, such a judgment is likely to have effects outside the state in which it is rendered.

Michael Greve explains:

> Products liability litigation under state law is the paradigmatic violation of state integrity. Manufacturers have no practical way of keeping their products out of particular jurisdictions. Plaintiffs, on the other hand, get to choose their own forum and law. As a result, the most restrictive and plaintiff-friendly jurisdiction will effectively impose its liability and product norms on the entire country and redistribute income from out-of-state manufacturers (and their shareholders and workers) to in-state plaintiffs in the process.[35]

Any manufacturer found liable will have to consider how to prevent future injuries that might lead to future verdicts. This effort will necessarily run into the practicality issues that the Subcommittee identified and the Coast Guard recognized in 1990. It would also proceed in the face of the Coast Guard's inability and failure to promulgate a regulation since 1990.[36] Finally, it might well run into market resistance: The Subcommittee noted that propeller guards adversely affected performance by limiting speed, prompting the question whether a consumer would buy a planing vessel if that vessel's speed were limited by a propeller guard.[37]

As the Court observes, the parade of horribles is not certain to follow. It notes, "Because the pre-emption defense raises a threshold issue, we have no occasion to consider the merits of petitioner's claims, or even whether the claims are viable as a matter of Illinois law."[38] Even so, the rejection of the preemption defense allows the parade of horribles to prepare to make ready to mobilize. Agency regulators could have stopped the propeller guard parade and can stop such parades in the future. They should exercise this power whenever, after serious study, they make an "intentional and carefully considered" decision that promulgating a regulatory standard is inappropriate by cloaking it with administrative process.

* Jack Park is an Assistant Attorney General of the State of Alabama. The statements, opinions and views expressed herein are those of the author only and do not represent the views either of the Federalist Society or the State of Alabama.

Footnotes

1. 123 S. Ct. 518 (2002).

2. By tort preemption, this article refers to cases in which state law or common law tort claims are alleged to be preempted by federal law. Preemption issues also arise in the ERISA and Medicaid contexts. In its current term, the Court has two Medicaid preemption cases on its

docket. *See* Ky. Ass'n of Health Plans, Inc. v. Miller, 123 S. Ct. 1471 (2002); Pharmaceutical Research & Mfrs. of Am. v. Concannon, 249 F.3d 66 (1st Cir. 2001), *cert. granted*, 536 U.S. 956 (2002).

3. In that regard, railroad crossing claims are preempted, see *Norfolk S. Ry. Co. v. Shanklin*, 529 U.S. 344 (2000), but pacemaker claims are not, see *Medtronic, Inc. v. Lohr*, 518 U.S. 470 (1996).

4. 529 U.S. 861 (2000).

5. Sprietsma v. Mercury Marine, 757 N.E.2d 75 (Ill. 2001).

6. *See* 46 U.S.C. § 4306. That provision prohibits states and their subdivisions from:

> establish[ing], continu[ing] in effect, or enforc[ing] a law or regulation establishing a recreational vessel or associated equipment performance or other safety standard or imposing a requirement for associated equipment (except insofar as the State or political subdivision may, in the absence of the Secretary's disapproval, regulate the carrying or use of marine safety articles to meet uniquely hazardous conditions or circumstances within the State) that is not identical to a regulation prescribed under section 4302 of this title.

Id. In *Sprietsma*, the Court observed, "[T]he article 'a' before 'law or regulation' implies a discreteness—which is embodied in statutes and regulations—that is not present in the common law." 123 S. Ct. 518, 526 (2002).

7. 46 U.S.C. § 4311(g). That provision states, in pertinent part:

> Compliance with this chapter or standards, regulations, or orders prescribed under this chapter does not relieve a person from liability at common law or under State law.

Id. (citations omitted).

8. 529 U.S. at 868.

9. *See* 123 S. Ct. at 526.

10. *See, e.g.*, Dep't of Revenue of Or. v. ACF Indus., 510 U.S. 332, 340-341 (1994) (noting the "'elementary canon of construction that a statute should be interpreted so as not to render one part inoperative.'" (quoting Mountain States Tel. & Tel. Co. v. Pueblo of Santa Ana, 472 U.S. 237, 249 (1985) (internal quotation marks omitted in original))).

11. *Sprietsma*, 123 S. Ct. at 527 (quoting *Geier*, 529 U.S. at 869; Freightliner Corp. v. Myrick, 514 U.S. 280, 287 (1995)) (internal quotation marks and citations omitted in original).

12. *See* 46 U.S.C. § 4302(a)(1), (a)(2). The Secretary of Transportation delegated the authority to promulgate those regulations to the Coast Guard. *See* 49 C.F.R. § 1.46(n)(1) (1997).

13. 46 U.S.C. § 4302(c). The Advisory Council consists of 21 members, with 7 members drawn from each of three interested groups: State officials; manufacturers; and "national recreational boating organizations and . . . the general public." 46 U.S.C. § 13110(a), (b)(1).

14. *See* 46 U.S.C. § 4305.

15. *Sprietsma*, 123 S. Ct. at 525 (citation omitted).

16. *See* Brief for the United States As Amicus Curiae Supporting Petitioner at 5, *Sprietsma* (No. 01-706) (citation omitted); *see also* Brief for the Respondent at 49 n.21, *Sprietsma* (No. 01-706) ("Roughly 80 percent of propeller accidents occur at 'speeds in excess of 10 miles per hour,' and 'a skull impact at 10 mph or more in the water would be generally fatal'—'even with an idealized cushioning material, not currently known to exist.'") (citation omitted); *id*. at 49 ("Similarly, the Subcommittee found that 'it is not practical or feasible to mandate guards for specific uses' and that guards only work for boats that operate at 'slow speeds.'") (citation omitted).

17. Brief for the United States As Amicus Curiae Supporting Petitioner at 5-6, *Sprietsma* (No. 01-706).

18. *See Sprietsma*, 123 S. Ct. at 525 n.9.

19. Federal Requirements For Propeller Injury Avoidance Measures, 66 Fed. Reg. 63,645 (proposed Dec. 10, 2001). The Coast Guard estimated that this rule would "impose a $ 12 to $ 30 million economic cost on owners of approximately 100,000 non-planing houseboats." *Id.* at 63,647. The proposed regulations would also define non-planing and planing vessels as follows:

> *Non-planing vessel* means a vessel with a hull that is designed to ride through the water at any speed.
>
> *Planing vessel* means a vessel with a hull that is designed to ride on top of the water beyond a minimum speed.

Id. at 63,649.

20. *Sprietsma*, 123 S. Ct. at 526 (emphasis added). For an existing planing vessel, the Advisory Council had recommended that the Coast Guard adopt a regulation that would "'[r]equire owners of all propeller driven vessels 12 feet in length and longer with propellers aft of the transom to display propeller warning labels and to employ an emergency cut-off switch, where installed.'" *Id.* at 525 n.9 (quoting Federal Requirements For Propeller Injury Avoidance Measures, 66 Fed. Reg. at 63,647).

21. *Id*. at 527.

22. *Id*. at 527-28 (emphasis added).

23. *Id*. at 528 (quoting Ark. Elec. Coop. Corp. v. Ark. Pub. Serv. Comm'n, 461 U.S. 375, 384 (1983)).

24. *Id*.

25. Geier v. Am. Honda Motor Co., 529 U.S. 861, 879 (2000) (quoting Federal Motor Vehicle Safety Standard; Occupant Crash Protection, 49 Fed. Reg. 28,962, 29,001 (July 17, 1984) (to be codified at 49 C.F.R. pt. 571).

26. 123 S. Ct. at 529 (quoting *Geier*, 529 U.S. at 881).

27. Brief for the United States as Amicus Curiae Supporting Affirmance at 9, *Geier* (No. 98-1811).

28. Brief for the United States As Amicus Curiae Supporting Petitioner at 25-26, *Sprietsma* (No. 01-706).

29. *Id*. at 26.

30. *Id*. at 26-27.

31. *Id*. at 27.

32. *See* 123 S. Ct. at 528.

33. Brief for the United States As Amicus Curiae Supporting Petitioner at 24, *Sprietsma* (No. 01-706). (citing Freightliner Corp. v. Myrick, 514 U.S. 280, 286-87 (1995)).

34. *Sprietsma*, 123 S. Ct. at 530.

35. Michael S. Greve, *Federalism's Frontier*, 7 TEX. REV. L. & POL. 93, 100 (2002) (footnotes omitted).

36. The Coast Guard's hesitation may well be laudable. The National Highway Traffic Safety Administration had to amend its airbag standard in 2000 to add new requirements, test procedures, and injury criteria to address the risks that airbags pose to small women and young children. The difficulties faced by regulators who have studied an issue counsels against tendering the question to civil juries sitting in particularized cases. *See* Federal Motor Vehicle Safety Standards; Occupant Crash Protection, 65 Fed. Reg. 30,680 (May 12, 2000) (to be codified at 49 C.F.R. pts. 552, 571, 585 & 595) (amending "our occupant crash protection standard to require that future air bags be designed to create less risk of serious air bag-induced injuries than current air bags").

37. *See* Brief for the National Association of Manufacturers and the National Marine Manufacturers Association as Amici Curiae in Support of Respondent at 27, *Sprietsma* (No. 01-706) (noting the Subcommittee's conclusion that requiring propeller guards posed other problems including "'affecting boat operation adversely' at 'speeds of approximately 10 mph or greater.'") (citation omitted).

38. *Sprietsma*, 123 S. Ct. at 522.

THE ROLE OF THE SENATE IN JUDICIAL CONFIRMATIONS *BY STEPHEN B. PRESSER**

JUDICIAL APPOINTMENTS: A CONSTITUTIONAL ANALYSIS *BY MICHAEL B. RAPPAPORT**

The Role of the Senate in Judicial Confirmations by Stephen B. Presser

For the last few weeks, a constitutional crisis has been brewing in the United States Senate. It is a constitutional crisis all but ignored by the public, but the resolution of this crisis is likely to determine the nature of federal jurisprudence for the next few decades. At one level, the struggle in the Senate is a struggle over one or two notable nominees to the lower federal courts, most particularly Miguel Estrada and Priscilla Owen, but, at a deeper level, the struggle is over what many of the Senate Democrats have called "judicial ideology," by which they mean a disposition to decide particular cases in a particular manner. For the first time in memory, in public, one political party, the Senate Democrats, has taken the position not only that judges should be picked based on their preference for designated outcomes in cases that might come before them, but also that the Senate ought to be an equal partner in picking judges and that nominees who come before the Senate have a burden of persuading sixty Senators (the number necessary to cut off debate in the Senate), that they are worthy of ascension to the bench.

For those of us who still believe that judging ought to be impartial, that there actually is content to the rule of law, and that it ought not to be the task of judges to make policy from the bench, there is cause for great alarm over what is now happening in the Senate. It was that alarm, of course, even before the current imbroglio, that led candidate Bush to proclaim that he wanted to appoint judges who would interpret, not make law, and to point to Supreme Court Justices Antonin Scalia and Clarence Thomas as his models. Now that he has sought to do just that, those uncomfortable with the jurisprudence of Scalia and Thomas, those who would like to see constitutional interpretation as something other than fidelity to the original understanding of that document, have sought to deny Bush nominees confirmation. There is reason to be upset then, not only over the Senate's frustrating the constitutional task of the President, but also over the theory of judging that lies behind the Democrats' refusal to allow Senate votes on some of the Bush nominees.

Let's take the constitutionality of what Miguel Estrada's opponents have done as our first point of inquiry. Estrada served with distinction in the Solicitor General's office. In both private practice and in the government, he was a respected member of the bar of the United States Supreme Court. He had a splendid law school record at Harvard Law School, and he secured a prestigious clerkship with Supreme Court Justice Anthony Kennedy. He had hearings before the Senate Judiciary Committee. He was unanimously rated "well-qualified" by the American Bar Association body charged with passing on nominees, formerly the "gold-standard" of qualifications for the bench, by the very Senate Democrats who now oppose his nomination. These opponents know that if the Estrada nomination is ever brought to a vote on the Senate floor, he will be confirmed, but they have managed to avoid such a vote by filibustering and invoking Senate Rule XXII. That rule, the "cloture" provision, states that the only way to cut off debate on a nomination or a pending bill is by a motion for which 60 of the 100 senators vote "aye." Rule XXII and the other Senate Rules can be changed only by the vote of two-thirds of the senators present, so that, as long as Estrada's opponents number more than 40, they can prevent a vote on his nomination. As this is written, the Estrada opponents have just begun employing the same tactic to prevent a vote on the nomination of Priscilla Owen, a Texas Supreme Court Justice with credentials as impressive as those of Estrada, and who also received the ABA's "well-qualified" ranking. Other Bush nominees are likely to be treated in an identical matter.

By invoking Senate Rule XXII, used now for the first time in connection with a nominee to the lower federal courts (there is one instance of the practice having been used against a Supreme Court nominee, the bipartisan move against Lyndon Johnson's nomination of Abe Fortas for chief justice, which nomination was eventually withdrawn), the Democrat minority in the Senate, has, in effect, raised the number of Senators necessary to confirm a nominee from the mere majority previously regarded as sufficient to confirm, to the super-majority requirement of 60. As John C. Armor, writing for UPI, recently observed, since other constitutional provisions, notably the clauses regarding treaties, impeachments, expelling members, overriding presidential vetoes and constitutional amendments expressly require two-thirds supermajorities, the clear implication is that the clause regarding confirmation of judicial nominees, which merely speaks of "Advice and Consent," should not.[1] One could then argue that Senate Rule XXII, at least when used to defeat a judicial nominee by denying him a vote on the Senate floor, unconstitutionally raises the number of votes required for confirmation, and thus ought not to be permitted to frustrate the President's appointment power. Intriguingly enough, when the same problem was affecting appointments during the term of President Clinton, one of his most distinguished counsel, Washington super-lawyer Lloyd Cutler, made just that argument in an op-ed piece published in the *Washington Post* on April 19, 1993, suggesting that the unconstitutional rule be abolished. This could be accomplished, Cutler wrote, if

> [t]he Senate Rules Committee, [which the Republicans now control], would approve an amendment of Rule XXII permitting a majority to cut off debate after some reasonable period. When the amendment comes before the Senate, the [Republicans] would need to muster only 51 favorable votes (or 50 plus the vice president's vote).[2]

Cutler recommended that a senator

> would raise a point of order that this number is sufficient either to pass the amendment or to cut off debate against it, because the super-majority requirements of Rule XXII are unconstitutional. The vice president would support this view, backed up by an opinion of the attorney general. Following Senate custom on constitutional points, the vice president would refer the question to a vote of the entire Senate, where the same 51 or more votes, or 50 plus the vice president's vote, would sustain it.[3]

At that point Rule XXII would be history and the problem of unconstitutionality would vanish, as the Senate would be able to cut off debate by a mere majority vote. Cutler had recommended this course to Democrats, of course, but his strategy could be used by Republicans, as well. Unfortunately, there is great reluctance to overturn longstanding Senate practice, such as Rule XXII, but if there ever were an occasion for it, it might well be the first time in history that Rule XXII has been used to defeat a lower-court nominee.

Overturning Rule XXII at this time, or using some other means to stop the frustration of Estrada's and Owen's appointments would also be wise because the motivation behind the Democrat Senators' frustrating tactics is a serious revision of the original understanding of the appointment powers and the Senate's role in the process. In two hearings on the judicial appointments process while the Democrats still controlled the Senate, in an effort to challenge the nomination philosophy candidate Bush had expressed on the campaign trail, Senator Charles Schumer of New York made clear his belief (buttressed by some academics friendly to the Democrats' point of view) that it ought to be the task of the Senate to achieve a "balance" of judicial ideologies on the bench, and that each nominee had a burden of satisfying the Senators he or she was qualified for the position.[4] By "judicial ideology," Senator Schumer made clear at those hearings, he meant a belief that particular judicial decisions, including apparently many regarding race, religion, and abortion, were correctly decided and ought to be expansively applied and followed in the future. Senator Schumer (and some of his witnesses) strongly suggested that any Bush nominee with contrary views ought not to be permitted to be confirmed unless a nominee with a "judicial ideology" favored by Senator Schumer and those like him was also confirmed, in order to maintain "balance."

There is, of course, no constitutional requirement of "balance" on the bench, and, more importantly, Senator Schumer's concept of "judicial ideology," seems inconsistent with the Constitution's presumption with regard to judging. *Federalist No. 78*, and the writing of the Founders tells us that the proper "judicial philosophy" (*not* "judicial ideology"), is to decide cases according to a neutral interpretation of the Constitution and laws.[5] Judges are not to arrive on the bench with a preconceived set of responses or determined to implement a particular "ideology." Senator Schumer, pursuant to ascendant ideas in the legal academy about judges as forces for social change, has a different conception of judging, and wants a bench that will implement the policies he and many of his fellow Democrats favor. President Bush has made clear that he does not share that view, and his remarks about preferring judges who will not legislate from the bench (the views also of Scalia and Thomas) put him squarely at odds with Senator Schumer. If the President is forced (by the unconstitutional application of Rule XXII, or by other means) to give up half of his nominations to satisfy some Senators' ideological preferences, his constitutional appointment powers will have been severely compromised.

Those powers would be similarly compromised if Senator Schumer's notion that nominees have a burden of proof they must meet to satisfy ideologically-driven Senators goes unchallenged. According to *The Federalist*, at least, and according also to the prevailing practice in more than two centuries of judicial appointments, a presumption of fitness has been generally accorded to presidential judicial nominees, and the Senate has properly opposed nominees only when they have been lacking in character or professional legal accomplishments. The authors of *The Federalist* made clear that the assignment of the "Advice and Consent" role to the Senate was to prevent the President from using the nomination process to reward unqualified or corrupt family members or cronies, and not to prevent him from actions taken in good faith to appoint qualified persons of high character. It is true that some nominees have been rejected or questioned on other grounds throughout our history (one thinks of the criticism leveled at Louis Brandeis, which did not prevent his confirmation, and that at Robert Bork, which did). It has been almost unheard of, however, for this kind of ideological litmus test to be applied to deny a confirmation vote to lower court nominees.

If President Bush is made to give in to the tactics of the Senate Democrats on this point, he will not only have suffered an ignoble political defeat, but he will have failed in his oath to support the Constitution, because he will have compromised his powers and will have seriously undermined the rule of law on which the Constitution depends. One suggestion that has been made, for example, by Victor Williams, is to do an end run around the Senate Democrats, by making a series of recess appointments of his judicial nominees. As Mr. Williams recently pointed out in the *National Law Journal*,

> Clause 3 of Article II, Section 2, states: "The President shall have Power to fill up all Vacancies that may happen during the Recess of the Senate, by granting Commissions which shall expire at the End of their next Session." The recess-appointments clause protects the government from Senate inaction and guarantees the ceaseless functioning of the judiciary. More than 300 jurists have risen to the bench via a recess appointment: Earl Warren, William Brennan, Potter Stewart, Griffin Bell and Augustus Hand, to name a few.[6]

Mr. Williams notes that John F. Kennedy "recess-appointed more than 20% of his judges, and each was subsequently confirmed for a tenured bench. . . . It was just such a Kennedy recess appointment that placed Thurgood Marshall, then a successful lawyer for the National Association for the Advancement of Colored People, on the 2d Circuit."[7] President Clinton made similar use of the recess appointment power, and there is, thus, precedent for President Bush to go that route. Still, the Republicans criticized Clinton for his attempt to circumvent the confirmation process through recess appointments. Thus, recess appointments for President Bush's nominees, though they ought to be considered if there are not other alternatives, are still a dubious attempt to make two wrongs equal a right.

My casebook co-author, Catholic Law School's Dean Douglas Kmiec, recently wrote in the *Wall Street Journal* that what is being done to Miguel Estrada is a "national disgrace."[8] He favors stopping the Democrat Senators' tactics by a frontal attack on "Senate Rule V, [which] provides that the rules of the Senate shall continue from one Congress to the next unless amended by two-thirds of those present and voting."[9] Dean Kmiec notes that "[t]his violates fundamental law as old as Sir William Blackstone, who observed in the mid-18th century that 'Acts of Parliament derogatory from the power of subsequent parliaments bind not.'"[10]

Kmiec also observes that

> the Supreme Court has repeatedly held that the legislature does not have the power to bind itself in the future. As the Court stated in *Ohio Life Ins. and Trust Co. v. Debolt* (1853), for the political process to remain representative and accountable, 'every succeeding Legislature possesses the same jurisdiction and power . . . as its predecessors. The latter must have the same power of repeal and modification which the former had of enactment, neither more nor less.[11]

This is a good strategy for preventing the filibuster's use as a means of changing the constitutional requirements for nominees, and would solve the problem, but perhaps such drastic means would not be necessary if President Bush (now that the War in Iraq is coming to an end and rebuilding has begun) were to make a few prime-time speeches exposing the manner in which the Senate is frustrating his appointment power through tactics of dubious constitutionality and in complete derogation of the traditional conception of the role of judges, Senators, and Presidents.

* Stephen B. Presser is the Raoul Berger Professor of Legal History at Northwestern University School of Law, a Professor of Business Law at Northwestern's Kellogg Graduate School of Management, and an Associate Research Fellow at the University of London's Institute of United State's Studies. Professor Presser was an invited witness before Senator Schumer's Senate Judiciary Subcommittee which held hearings on "Judicial Ideology" in June of 2001.

Judicial Appointments: A Constitutional Analysis by Michael B. Rappaport

In "The Role of the Senate in Judicial Confirmations," Professor Stephen Presser eloquently argues that Senate Democrats have behaved improperly concerning the nominations of Miguel Estrada and Priscilla Owen. Professor Presser rightly condemns the Senate Democrats for opposing Estrada and Owen because they would seek to apply the actual Constitution rather than the political preferences of Senate Democrats. Presser also justly criticizes the Senate Democrats for taking the nation another step down the road to politicization of judicial appointments by filibustering lower court nominees based on political disagreements.

While I agree with these criticisms of Senate Democrats, Professor Presser also argues that the Senate Democrats have acted unconstitutionally. It is here where Presser and I part company. Although the Senate Democrats have a faulty constitutional vision, their tactics have not been unconstitutional.

When politicians behave badly, as the Senate Democrats have, there is a tendency, especially among constitutional lawyers, to view their actions as violating the Constitution. Although this reaction is understandable, defenders of the rule of law must resist the temptation, because it is essentially commits the same error, of reading one's political preferences into the Constitution, that our opponents have made.

Professor Presser addresses three main constitutional issues. First, and most importantly, he maintains that the filibuster, especially as used against judicial nominees, is unconstitutional. Second, he appears to argue that the Constitution contemplates that the President should have the primary role in appointments and that the Senate should defer to presidential nominees. I disagree with both of these arguments. Finally, Presser raises the possibility of the President making recess appointments of these nominees. Although his argument here is hard to interpret, I also believe that we have different positions on this issue.

First, Professor Presser mistakenly argues that the filibuster is unconstitutional, because it is inconsistent with a constitutional requirement of majority rule in the Senate. In a series of articles, John McGinnis and I have shown that when the Constitution does not specifically mention a voting rule, as with the confirmation of judicial nominees and the passage of bills, it allows each house to choose the voting rule it desires.[12]

For example, after the Republicans gained control of the Congress in 1994, the House of Representatives enacted a rule that required a three-fifths supermajority to pass increases in income tax rates. Liberals such as Bruce Ackerman claimed that the three-fifths rule was unconstitutional. Relying on an argument that Presser also uses, Ackerman contended that the fact that the Constitution specifically requires supermajority rules in certain instances, such as treaties and impeachments, indicates that majority rule was required in other situations. McGinnis and I argued, however, that this inference was unwarranted. When it does not specify a voting rule, the Constitution leaves the choice of the voting rule to the individual house by providing that "each House may determine the Rules of its Proceedings."[13] Rules of proceedings include, of course, voting rules.

The Constitution does place one important limit on each house's voting rules. It prevents a house from entrenching a voting rule against repeal by a majority.[14] For example, it would be unconstitutional for the House to require anything more than a majority to repeal the three-fifths rule.

There are at least two reasons why the Constitution allows each house to select ordinary voting rules, but prevents them from entrenching those voting rules against repeal by a majority. First, while ordinary voting rules can require a supermajority to enact a measure, these voting rules can be changed by a majority. By contrast, entrenched rules cannot be changed by a majority and might even be drafted to permit changes only with unanimous support. Consequently, entrenched rules function like constitutional amendments. The Constitution, however, requires that such amendments be passed only through the double supermajority rule specified in Article V. Second, legislatures were historically understood not to have the authority to bind future legislatures, as Blackstone's statement that Presser quotes suggests. While an ordinary voting rule that requires a supermajority does not bind a future legislature, because a majority of that legislature an change the voting rule, entrenched rules do restrain a majority of the future legislature.

The same analysis applies to the filibuster. The filibuster rule—the rule that allows Senators to prevent a vote by continuing to debate unless three-fifths of the Senate votes to end debate—is not unconstitutional. It is simply a Senate rule that has the effect of requiring three-fifths of the Senate to take actions and is therefore as constitutional as the House three-fifths rule for income tax rate increases. What is problematic and distinguishes the filibuster from the three-fifths rule is that the filibuster rule cannot be changed by

a majority. There is a separate provision that allows a filibuster of changes in the Senate rules—call it the rules filibuster—which requires not three-fifths, but two-thirds of the Senate to end debate. It is the rules filibuster, not the ordinary filibuster, that is unconstitutional.

Because it is only the rules filibuster that is unconstitutional, the filibustering of Estrada has not been unconstitutional. If the Republicans thought that the Estrada filibuster was improper, they could seek to amend the Senate rules to prevent filibusters of judicial nominees (or even just to exempt the Estrada nomination from the filibuster). If the Senate Democrats chose to filibuster that amendment, then they would be acting unconstitutionally and the Senate Republicans could seek to have the Senate declare the rules filibuster unconstitutional. Significantly, several past Vice Presidents, in their role as President of the Senate, have opined that a majority of the Senate must have some ability to change the rules, despite the existence of the rules filibuster. While a clear holding that the rules filibuster was unconstitutional would certainly have an effect on legislative practice, it would have less of an effect than a holding that the filibuster was unconstitutional, because the former holding would allow supermajority rules in both the House and Senate to continue to operate.

Although a majority of the Senate would be able to amend the ordinary filibuster rule under this analysis, that does not mean that the rule would always be amended (or an exception created) whenever a majority wanted to end debate. Senators may vote to end a particular filibuster, but not be willing to amend the filibuster rule to stop that filibuster. Senators may be reluctant to create exceptions to the filibuster rule for a variety of reasons, including respect for the traditions of the Senate or a preference for generally operating the Senate in accordance with the filibuster rule.

Let me now turn to Professor Presser's second constitutional claim. Professor Presser appears to argue that the Constitution assigns to the President the primary role in appointments and limits the Senate to rejecting candidates who lack good character or professional accomplishments. I say that he "appears" to make this argument, because his essay expressly refers only to the intent of the Framers and to a two-century tradition. If Presser does believe that the Constitution assigns the Senate this secondary role, I disagree with him. There is nothing in the Constitution that prohibits the Senate from assessing nominees based on the same criteria as the President. The text says that the President should "nominate" and that the Senate should give "Advice and Consent." To conclude that the President may consider a broader range of matters when he nominates than the Senate may consider when it consents, one would need evidence, which has not been provided, that the terms "nominate" and "Consent" had these special meanings at the time of the Framing.

What the Constitution does do, however, is to establish a process in which the Senate will ordinarily choose to exercise a more limited role than the President. The Constitution gives the President a first mover advantage, which places the President in a different position than the Senate. The President can nominate essentially anyone that he chooses, but the Senate must then determine whether to confirm this one person. When considering a particular individual, it is natural for the Senate and the public to examine the individual's personal merits. If he is qualified and honorable, then it seems unfair not to confirm him. Moreover, if he is rejected based on the political content of his legal views, then this would simply force the President to nominate another individual, causing additional controversy and delay.

While the appointment process gives the President an advantage, that does not mean that the Constitution *requires* that the Senate be deferential. Senatorial deference may be a result of the process that the Constitution established, but it is not one of the rules that govern the process. This point can be illustrated by considering the question whether Representatives should follow the views of the electorate on significant public questions. While the Constitution establishes an electoral process that provides Representatives with an incentive to consider the electorate's opinions on important questions, there is no constitutional requirement that the Representatives follow the public's views.

The third constitutional issue addressed by Professor Presser is the possible recess appointment of Estrada or Owen. Under the Recess Appointments Clause, the President can make appointments to vacant offices when the Senate is in an appropriate recess. Professor Presser's argument on this issue is difficult to interpret. It is not clear whether he believes a recess appointment of Estrada or Owen would be constitutional but questionable policy, constitutional but of uncertain political expediency, or simply unconstitutional. Presser notes that Presidents have used this power to appoint judges in the past, including Supreme Court justices, and that the power protects the government from Senate inaction. Nonetheless, he writes that "Republicans criticized Clinton for his attempt to circumvent the confirmation process through recess appointments," that such appointments ought to be employed only as a last resort, and that they would be "a dubious attempt to make two wrongs equal a right."

It is also not clear why Professor Presser has such a dim view of recess appointments. While Republicans may have criticized President Clinton's use of recess appointments, they have also used the filibuster that Presser criticizes. Moreover there was less justification for President Clinton to use recess appointments, because the Republicans had not filibustered any of his judicial nominees.

In fact, at first glance, it might seem that recess appointments would be an appropriate method for appointing persons whom the President believes the Senate has treated unfairly. When the Senate refuses to confirm a nominee for questionable reasons, the President could recess appoint that person. That would allow the person to serve, under public scrutiny, and to prove that he could perform the job. But there would be a check on the President, since the appointment of an unqualified person would cause the President to suffer politically. Thus, one might view the Recess Appointments Clause as a curb on the Senate's ability to behave unreasonably as to appointments. This use of the Recess Appointments Clause might seem especially appropriate as to someone in Estrada's position, who has received a hearing, been approved, been sent to the full Senate, and would be confirmed if he were not filibustered. On the other hand, it might be reasonably argued that recess appointments for judicial offices are often ineffective. While they allow the nominee to serve, it is only for a short time and the recess appointment may cause some Senators to harden their resolve against the full appointment.

Another reason that recess appointments are often considered questionable is that the President's authority appears so extensive. Under the prevailing interpretation, a recess appointment can be made for any office so long as the Senate is in an appropriate recess, even if the vacancy initially occurred while the Senate was in session. As a result, virtually any nominee who is not quickly confirmed by the Senate can be recess appointed and therefore this power appears to circumvent the confirmation process.

In my view, the Clause should be interpreted more narrowly to permit recess appointments only when the vacancy arises during a recess *and* the appointment is made during that recess. While there is not space here to fully develop the argument, this interpretation is superior in terms of text, history, and structure. First, this interpretation better fits the language of the Clause, which provides the President with the power "to fill up all Vacancies that *may happen during* the Recess of the Senate."[15] This language suggests a vacancy that arises during a recess, not one that originates while the Senate is in session and continues into a recess. Second, this interpretation accords more with constitutional structure and purpose, because it furthers what appears to have been the evident purpose of the Clause—to allow appointments during long periods when the Senate was not in session but not to permit the President to circumvent the confirmation requirement. Third, this interpretation also is superior in terms of the original understanding of the Constitution. For example, Edmund Randolph, an important constitutional Framer, wrote a legal opinion in 1792, as the first Attorney General, concluding that a vacancy that arose while the Senate was in session could not be filled by a recess appointment even when the Senate was in recess.[16]

Under my view, then, Estrada and Owen could not be recess appointed to the judicial offices for which they have been nominated. Even if these offices first became vacant during recesses, those recesses have long since ended. Yet, it might still be possible for the President to recess appoint these nominees. If a vacancy were to arise, during an appropriate recess, on the circuits for which Estrada and Owen have been previously nominated, the President could recess appoint them during that recess.

In the end, while I share Professor Presser's view that the filibustering of Estrada is a travesty (as would be the filibustering of Owen), I do not believe that the Senate is usurping the President's appointment powers or that the filibuster is unconstitutional. The problems with the behavior of the Senate Democrats is that they are further politicizing an already excessively politicized appointment process and are filibustering nominees because those nominees would apply the original meaning of the Constitution rather than the Senate Democrats' political preferences.

The nominations of Estrada and Owen are now significant political questions and the President should treat them as such. Unfortunately, as the judiciary's powers have expanded, judicial appointments have come to require the expenditure of more political capital. Fortunately, the extremity of the Senate Democrats' position makes their actions politically vulnerable. The President should use his popularity and position to highlight both the Senate Democrats' unprecedented behavior and how they urge the appointment of minorities, but then filibuster a truly superb nominee like Estrada. The President should also emphasize Estrada's personal odyssey from teenage immigrant to lawyer of extraordinary excellence. This is a political fight from which the President should not shy away, since it involves an important and worthy cause and is a contest which the President can win.

* Michael B. Rappaport is University Professor at the University of San Diego School of Law

Footnotes

1. John C. Armor, *Stop Judicial Filibusters*, United Press Int'l, Mar. 13, 2003 (citing "non-democratic clauses in the Constitution . . . . Some requir[ing] supra-majorities; some forbid[ing] certain decisions regardless of majorities in favor").
2. Lloyd Cutler, *The Way to Kill Senate Rule XXII*, Wash. Post, Apr. 19, 1993, at A23.
3. *Id.*
4. *See Judicial Nominations: Hearings Before the Senate Comm. on the Judiciary*, 107th Cong. (2002) (statement of Senator Charles Schumer) (taking testimony from multiple panels and discussing the nomination of Miguel Estrada). Senator Schumer stated, "Now, for the first time in a long time, there is balance on the DC circuit—four Republican judges, four Democrats. That doesn't mean each case is always decided right down the middle, but there's balance. Some of us believe that this all-important court should be kept in balance." *Id.*
5. *See, e.g.*, The Federalist No. 78 (Alexander Hamilton) ("The interpretation of the laws is the proper and peculiar province of the courts. A constitution is, in fact, and must be regarded by the judges, as a fundamental law. It therefore belongs to them to ascertain its meaning, as well as the meaning of any particular act proceeding from the legislative body. . . . The courts must declare the sense of the law; and if they should be disposed to exercise WILL instead of JUDGMENT, the consequence would equally be the substitution of their pleasure to that of the legislative body.").
6. Victor Williams, *Do a Recess Appointment*, Nat'l L.J., Mar. 10, 2003, *available at* http://www.nlj.com/oped/031003williams.shtml.
7. *Id.*
8. Douglas W. Kmiec, *Tedious—and Unconstitutional*, Wall St. J., Mar. 6, 2003, at A12.
9. *Id.*
10. *Id.*
11. *Id.*
12. *See, e.g.*, John O. McGinnis & Michael B. Rappaport, *Our Supermajoritarian Constitution*, 80 Tex. L. Rev. 703 (2002); John O. McGinnis & Michael B. Rappaport, *The Rights of Legislators and the Wrongs of Interpretation: A Further Defense of the Constitutionality of Legislative Supermajority Rules*, 47 Duke L.J. 327 (1997); John O. McGinnis & Michael B. Rappaport, *The Constitutionality of Supermajority Rules: A Defense*, 105 Yale L.J. 483 (1995).
13. U.S. Const. art. I, § 5, cl. 2.
14. *See* McGinnis & Rappaport, *The Constitutionality of Supermajority Rules: A Defense*, *supra* note 12, at 500-11.
15. U.S. Const. art. II, § 2, cl. 3 (emphasis added).
16. *See, e.g.*, John O. McGinnis, *Models of the Opinion Function of the Attorney General: A Normative, Descriptive, and Historical Prolegomenon*, 15 Cardozo L. Rev. 375, 376 (1993) (describing the Attorney General's opinion that "a recess appointment could be made only if the vacancy occurred during a recess of the Senate" (citing Letter from Edmund Randolph to Thomas Jefferson (July 7, 1792), *quoted in* John J. Reardon, Edmund Randolph: A Biography 205 (1974))).

Financial Services & E-Commerce

4th Annual Financial Services Conference

*Remarks by Hon. Peter R. Fisher**

HON. PETER FISHER: Continuous improvement in the efficiency with which we convert savings into investment is the preeminent objective that we, as a society, have for our financial intermediaries. We want both to minimize the potential loss of savings to individuals and society, and to maximize real risk-adjusted returns on investment.

For the last century and a half, we have sought to minimize the potential loss of savings by accepting a role for the federal government in promoting what in the late 19th Century we would have called monetary stability, but by the end of the 20th Century, we came to call financial stability.

In the last 20 years, we have begun to strip away the obsolete segmentation that the federal government imposed on our financial system, to shore up the soundness of financial intermediaries. That compartmentalized regulatory scheme imposed too great a constraint on financial intermediation. We have begun to dismantle these rigid functional and geographic barriers, but we have not yet fully accepted the supervisory and regulatory consequences of our loss of faith in the efficacy of those barriers.

We need now to follow through on the Congress' commitment to open up our financial services industry by focusing our regulatory efforts on promoting competition among all intermediaries. We are still concerned for financial stability, but in a more competitive more dynamic financial system, we must pursue this in a different way.

Supervisors of financial intermediaries need to be a little less concerned with preventing every bad outcome, and instead, should concentrate on improving the overall resilience of our financial system by thinking of it as a system. In the language of statistics, and distributions, and portfolio theory, supervisors should minimize negative Tail Outcomes by striving to maximize positive Tail Outcomes.

Now Adam Smith praised the invisible hand of individual incentive, but he was even more passionate in his animus toward the visible hand of government. His hostility was not to the exercise of government power per se, but rather to its likely abuse by men of commerce, particularly by the intermediaries or dealers seeking to limit their competition or gain privilege.

"The interest of the dealers", Smith wrote, "is always in some respect different from, and even opposite to that of the public. To widen the market and to narrow the competition is always in the interest of the dealers. To widen the market may frequently be agreeable enough to the interest of the public, but to narrow the competition must always be against it, and can serve only to enable the dealers by raising their profits above what they would naturally be, to levy for their own benefit an absurd tax upon the rest of their fellow citizens.

The proposal of any new law or regulation of commerce which comes from this order, ought always to be listened to with great precaution, and ought never to be adopted until after having been long and carefully examined, not only with the most scrupulous, but with the most suspicious attention."

Adam Smith's concern was mercantilism. Today, however, he would recognize the competition distorting consequences of all manner of subsidy, preference and guarantee, as well as the problems of agency capture and regulatory arbitrage.

Moreover, for most of the last two centuries in banking and finance, we tended to compound the general problem of competition distorting government interventions by the very means we use to protect the stability of financial intermediaries.

Through the sovereign's power to charter, we carved up the pathways of financial intermediation, allocating different sets of risks and returns as franchises for different forms of intermediation, deposit taking and loan making, investment underwriting, insurance underwriting, brokering and so forth. Holding less than the total set of available risks and returns from financial intermediation, any one form is necessarily less robust, less stable than the full set. By itself, each is prone to crisis in the event that its particular form of arbitrage suffers an abrupt or prolonged period of below average returns.

Each chartering authority reasonably sees its mission, however, as preserving the safety and soundness of its particular set of charges. To counterbalance their vulnerability to crisis, the chartering authority is tempted to pad the revenues of its franchisees by limiting the competition they face, or by providing special privileges not available to competitors.

These added returns, however, do not promote the efficiency with which society convert savings into investment. They represent a toll, Smith's absurd tax. Nor are the returns so extracted from our savings likely to make that particular form of intermediation any more robust in the long run.

We Americans made matters even worse with the misguided thought reflected in Glass Stiegel that the set of risks and returns called commercial banking could be made stronger by a rigid separation from the rest of the intermediation pathways, and particularly, from the set of risks and returns called investment banking.

In the late 1980s, starting with the regulatory reforms of the Federal Reserve Board, and eventually with the passage of the Gramm-Leach-Bliley Act in 1999, we began deconstructing the forced compartmentalization of our financial services industry. We need now to see this process through by clearing out the cobwebs of regulatory arbitrage that restrict which firms can provide which financial services.

We have and want to retain different forms of financial intermediation, but we also want to encourage vigorous competition at the frontiers among these forums, and the firms that provide them. Our system of financial rule writing, and particularly the licensing and chartering of financial service providers needs to respect this dialectic, promoting alternative forms of intermediation and vigorous competition among them. Limitations on who can compete, and how they can compete should be viewed wit the most suspicious attention. In a more competitive, more rough-and-tumble financial environment, we may have more, not less concern for financial stability for minimizing the potential loss of savings for individuals and society.

The supervision of financial intermediaries, the hands-on job of looking over the shoulders of individual financial institutions, originates with a desire to avoid some set of bad outcomes, bank failures, depositor losses, fraud, or some other form of consumer or social loss. The supervisory challenge is to limit these negative Tail Outcomes. To do so while promoting competition and efficiency, however, requires that we recognize that individual failures are part of an overall system that produces both negative and positive outcomes.

When we adopt this portfolio viewpoint, we see that the society as a whole is likely to benefit the most through the improvement of overall performance. We can do that best when we strive to maximize positive Tail Outcomes across the whole financial system. Snuffing out every bad outcome, that is stifling competition cannot be the way to spur the whole system to best performance.

Indeed at both the level of systemic stability and for any particular products or sales practices, the only compelling case for financial supervision is as a means of more rapidly disseminating best practice than would otherwise be the case, in order both to minimize the likelihood of bad outcomes, and to improve medium and mode outcomes for society.

There are two consequences of thinking of financial supervision in these terms. First, when we think of financial supervision in the context of the range of positive and negative outcomes that a particular form of financial intermediation produces, we better understand the systemic role of the supervisor. Over the extended time horizon and the total portfolio of intermediaries of concern to the supervisor, minimizing the loss of savings will be a consequence of, and not at odds with the striving for the positive Tail Outcomes that reflect convergence on best practice, and serve to maximize real risk-adjusted returns.

Second, in order to be an effective means of redistributing best practice, the supervisor needs to know what best practice is. This requires real knowledge and expertise about the risk and rewards of the particular businesses to be supervised. In the absence of this knowledge and expertise, the supervisor is unlikely to be able to promote best practice, and is more likely only to add to the cost of financial intermediation; and thereby, regrettably diminish the overall efficiency with which our savings are converted into investment.

At the practical level, in order to know best practice, supervisors need to be specialized by lines of business and sets of risks. If we can focus the role of the federal government on the twin tasks of expanding competition among the providers of financial services, and of channeling supervisory resources to serve as a means of redistributing best practice, we will be moving in the right direction.

Thank you very much. I'd be happy to answer your questions. All right. Or you can serve dessert if you'd like.

MR. COCHRAN: Can you talk about how that applies to the case of a proposal for an optional Federal Insurance Charter, and the real estate broker banking rules?

HON. PETER FISHER: Clearly in both cases, more competition is better than less, and I'll hold out both those issues to the question of how are they help moving us in the direction of getting toward more, not less competition.

I think the Insurance Charter question is one that I feel rather strongly about, that if there's going to be the advent of an entirely new edifice of federal financial supervision, someone had better explain to me how it's going to make the problems that I'm concerned about lessened, rather than increase regulatory arbitrage and barriers, so I don't take it at face value that simply creating a Federal Charter will lessen those. I think it remains to be seen whether the ideas that come forward for how we could go about that will actually serve to move us in the direction of more coherence in the federal role in rule writing for financial services, and I'll leave it at that.

MR. ELY: Peter, if I remember correctly, your talk today is building on your talk a few weeks ago at the Exchequer Club, and I have a question that follows up on Andy's question. It has to do with, shall we say the different philosophies towards safety and soundness that we see that have evolved in banking, in securities and insurance. And it seems to me that this comes to the fore as we talk about the optional Federal Insurance Charter, that there are beliefs that because these are significantly different businesses in some ways, there have to be differences in regulatory approach.

For instance, in banks versus property and casualty insurance companies, the banks would primarily

worry about what the value is of assets. Over in the P&C business, you not only have concerns about value of assets, but also very significant issues, much more significant issues in terms of how you estimate what liabilities are, again particularly when you get into Long Tail Liability-type insurance.

In the securities business, there's been a much more rigorous mark to market routine than we have traditionally had in banking.

How do you propose that these different philosophies, leaving aside the agencies, but the different philosophies get melded together, or do you envision the world where you still have different philosophies about safety and soundness as it applies to the insurance business, to the securities business, and to the banking business?

HON. PETER FISHER: I don't think it's at the level of philosophy. That's a great question, Bert, but I don't think it's at the level of philosophy. When I say I think we're going to have, we have, and we want to have different forms of intermediation, I think we need to preserve some core differences in ways that we intermediate risks and credit across time, and across parties, so I'm a kind of securities market guy, so I want to be the first to say, I think the mark to market discipline is a terrific one, but I wouldn't want to live in a society in which every form of financial intermediation was subjected to that. That's what I mean by we want to preserve different forms of financial intermediation.

Now I think that, and you can actually get to a rather refined question very quickly. The greater defenders of mark to market say well, you've got to mark to market. And you say oh, really? What about all that stuff you mark to model? Oh, well that's different. Well, you can right away inside the mark to market model. They're marking to model, which is a complicated way of saying to a bunch of assumptions we have about the nature of our form of intermediation, and when we may have to pay the piper. So I think we want there to be different forms of intermediation, intermediation across time, marking everything to market gives you a certain kind of crispness to the discipline.

We have to preserve that, but I think as I refer to it, the frontiers, I think we really know it when we see it, when we have two products that are identical for the consumer. The consumer is getting two products. They serve the same purpose. They provide either a borrowing or a savings vehicle, and they get hugely disparate regulatory treatment from a capital end, or on some other end, and now we're just going to run a regulatory arbitrage until we see how long society can stand it. And so, I think that I really, when I say it's about a dialectic process, I really, really mean that.

Forgive me. At the New York Fed they used to tell me please don't use that word. It's really eggheadish, but it really is what I mean. We want to try to preserve these core forms of intermediation because as a society, we don't want to put all our eggs in one basket. And we want that with the frontiers to create a rule writing process that says "wait a minute, we know here at the frontier you guys are doing the same thing, and we've got to sort this out, and figure out if there's going to be one rule for this." Otherwise, we're just running an arbitrage.

So I think there are ways, as I spelled out in my speech a couple of weeks ago, not at the Exchequer Club but at Brooklyn Law School, about how we could think about a rule writing mechanism that held people to this higher standard of like products and like services should get a like treatment while they pursue maintaining core disciplines on the different forms of intermediation. I think we can imagine a number of different ways of doing that, but where we are is, we're hiding ourselves. We're not confronting this issue, and we're leaving, like I say, the cobwebs of regulatory arbitrage in place.

That's one way of thinking about it, and I'm really not being coy. I'm trying to be exquisitely clear about what I think the objectives are. And I think I've thought about them, and I've observed capital markets and our financial system for a while. I think that's my expertise.

The right way of slicing and dicing the bureaucracy is not my expertise, but I'd like to hear ideas about the right way to serve these objectives in the long run. I mean, the different ways we could organize a mere bureaucracy to serve society's purposes better.

MR. ROGER: What's in it for us?

HON. PETER FISHER: No, no, that's fine. Who's us?

MR. ROGER: Us being the Neanderthal banking lobbyists. What's in it for us?

HON. PETER FISHER: Well, that's a good B-.

MR. ROGER: I mean, arbitrage is good sometimes.

HON. PETER FISHER: No, it's not. Let me be clear, you're on the wrong side of Adam Smith. Let me be clear.

MR. ROGER: I'm asking the question B-.

MR. VERDIER: He's patiently on the wrong side of the B-.

HON. PETER FISHER: Yeah. I think what's in it for you is the point at which the people who are paying the freight for you, get tired of paying for lobbyist for each of their subsidiaries to fight each other. And the question is, are you going to be the first to go, the most neanderthal, or the last to go? Because that process is underway.

The people at the top of the major financial services firms in America are tired of paying for phalanx of lobbyists to do war with each other on behalf of their different subsidiaries. And that's what their interest is in, is in reducing that as a business obstacle.

You think of yourself as a profit center, but when you step back, and as I look at it for society's interests, and for the larger companies who have lots of different products and are big enough now to be reasonable proxies for a broad national market, you're running an obstacle course for them on trying to get products out there that meet the broader demand, so I think that's a pretty big interest on your part. And I think it's certainly in society's interest, and as long as we're being candid about who's on society's side and who's not, I'll take the fight any day, but on the terms that you're trying to increase the absurd tax that Adam Smith was complaining about, and I'm trying to maximize the return on savings that the American people get. I'll take that debate any day. Any forum you want to have it, I'll take it.

MR. FEINBERG: The buzz word that you're alluding to is what Demming would call B- did call sub-optimization, so that it's a little obvious up here, we're trying to abrogate and often successfully an optimal solution at a very low level, and you're talking about how to achieve something better at the macro level.

The buzz words that are being heard around here are transparency, independence and accountability, but these don't apply to the fragmented segments of the financial services industry, or maybe the larger communications industry. Ultimately, would you think that it might be more difficult for those who are trying to carve out these protected areas and levy absurd taxes, more difficult for them to hide?

HON. PETER FISHER: Yes. I think that that, in fact, is part of what has been happening in our capital markets for the last two or three years. And I think that independent of our regulatory structure and the sort of B-, and I want to be clear, I'm referring to the regulatory, not the statutory structure in my remarks - I think part of what's going on is that the opportunities for arbitrage out in markets across the entire capital structure are putting pressure on firms that are too narrow in the arbitrage they're running. And so part of it B- there are lots of other contributors, I want to be clear, to what we've seen in asset markets over the last two or three years. But I think that that is part of what's going on out there on the market side, as well as say on the regulatory side. Absolutely.

MR. HYLAND: As a practical matter, when would the Bush Administration be B-.

HON. PETER FISHER: I'll repeat the question. The question is when might the Bush Administration have a proposal on this? And I don't have any idea. I don't have any concept of proposal. There's much too little consensus on this topic. There's much too much B- what I've been saying for the last 18 months is too many people think that Gramm-Leach-Bliley was Act Four of this drama. I think it was Act One. I think there are two or three more acts to go. We need more of a critical mass of consensus that this is B- that there is a lot more to go in this drama, and we need more consensus. It's premature, not enough people in this country understand how embarrassing we look from outside this country, how are financial regulatory landscape looks like the Keystone Cops, from London, or Frankfurt, or Singapore. And that's something that is a tax on us as a society, given our need for imported capital, I would point out. So I think we need a little more sense of urgency on the part of everyone before it would be fruitful to have a particular proposal.

MR. ELY: Are you envisioning or suggesting some kind of new federal entity with rule making authority that, in effect, could preempt individual agencies or individual groups of agencies, let's say like the banking regulators or insurance regulators, much the same way that the federal government can preempt the states and does regularly? Or are you envisioning something that's like the UK's FSA? I'm trying to figure out how this actually translates into some kind of bureaucratic reality.

HON. PETER FISHER: Certainly more of the former than the latter, but I don't — what you've just outlined is an intriguing way to think about it. I think that given my emphasis on the supervisory side, and as I've been clear before in remarks, I don't see any benefit from rolling up the supervisory component into a single agency.

MR. ELY: Your concern is with the rules.

HON. PETER FISHER: My concern is with the rules, so I think the FSA model that's been adopted in some countries, they're sort of putting it all in one place, doesn't do anything for me. It actually gets me off on the wrong foot, given how important I think the supervisory side is. I just — there's no particular reason why you're going to get faster to the right mix of expertise and discipline putting them all under one umbrella. There's just nothing there for me on that side.

On the rule writing side, you clearly get to a consciousness that there's one rule writer who has to think about the arbitrage at the frontiers, the warfare at the frontiers, but I don't have a disposition on the right bureaucratic forum. I really don't, but I want to be clear about the objective pro competition; that's, how could we invent system that would be pro competitive, much more pro competitive than we're used to, because habits — the first economist I worked for taught me wonderfully that habit is the most underestimated variable in human behavior, and therefore, in economic models. And we

changed - Gramm-Leach-Bliley was passed into law just three years ago - the habits of the prior 150 years haven't all disappeared, and how we think about charters, and who has what power, and who does what, and who can do what. We've got to strip those away, and that's why I'm looking for an engine, a pro competitive engine as an overlay somehow or other on our rule writing process.

MS. ANDREWS: If your philosophy of enhancing competition were taken down to let's say OTS and OCC, do those agencies have, if they were to adopt that philosophy, a duty to look at the impact of their regulation on the broader financial services market, which the banks and the savings institutions compete. And I use, for example, the mortgage lending industry where banks compete with non-state regulated lenders. So would the agencies have a duty to look beyond their own marketplace, their own membership, if you will?

HON. PETER FISHER: Well, that's the right thrust, but I don't know whether the right bureaucratic forum is to impose that duty on them, or have a right of appeal somewhere else if you think there's an arbitrage or some super rule writer over them. I don't know what mechanism, but that's a great example of all the different capital treatments we get throughout the whole mortgage pipeline. There are all kinds of different capital treatments all over the place, and we probably ought to think about, as a society, whether we want to have that amount of arbitrage or a little less going on.

MS. ANDREWS: I want to use a specific example with the Alternative Mortgage Parity Act, where the OTS has issued a rule that is going to eliminate the preemption that was given to alternative mortgage lenders in a couple of areas, prepayment penalties and, I forgot the other one. But anyway, so that's an example where an action of an agency is actually hurting competition in a market in which the savings institutions are actually given a competitive advantage against the state's mortgage lenders.

HON. PETER FISHER: I'm not familiar with the particulars right there, but that's the sort of issue I'd want to see a mechanism to be squeezing out over time.

MR. DOUGLAS: In terms of enhancing competition and sort of artificial barriers, do you have any thoughts on the ownership of banks in terms of the area that was driven or created by the Bank Holding Company Act, in terms of the types of entities that may own and operate commercial banks?

HON. PETER FISHER: I haven't thought of it as a — I mean, we have restrictions on all kinds of intermediaries, not just banks and bank holding companies as to who can own what, going to fitness, if you will. And obviously, some of those are entirely appropriate and some of those are masks for limiting competition.

I'm not familiar with the current state of play and how those rules are being treated for banks. I'm a little more concerned. I'll give you B- when I look at the problem of someone taking a charter, some equity holder who owns a financial institution. We'll use a bank or an S&L for the moment, and they actually have a broader range of returns. And they try to take that charter and have it take on just a particular slice of risk in returns, and they run a high risk strategy. That's a big problem, because then they're using that charter as part of a strategy of getting returns in their total portfolio, but in my frame of reference, we know that narrow arbitrage strategy may blow up under certain conditions. And it may have worked for them as portfolio holders, but it doesn't really work given our interest in financial stability and federal safety.

MR. DOUGLAS: So that becomes an issue of how you supervise or put the parameters around the box that we call a bank.

HON. PETER FISHER: Yeah, it does. I feel the same way about any charter.

MR. DOUGLAS: Right. But in terms of say, just a hypothetical out of thin air, a Wal-Mart acquiring a depository institution, is there any sort of philosophical basis for saying yes or not to that?

HON. PETER FISHER: Just never thought about that question.

MR. PEMBERTON: I've got to preface, I'm a lawyer. I'm not an economist, and I don't even balance my checkbook. So the premise that you put forth that we don't have the competition, I guess I don't understand fully why that would be. It seems like a perverse sense, we have exactly the kind of systematics that would have envisioned where we have these competing forums and charters. And even in the last 20 years, you know, people used to put money in banks and then mutual funds became sort of an option. A lot of individuals now have mutual funds, and you know, banks want to get B- you know, they want fee income, so they start offering mutual funds, and they find other services they want to offer.

I mean, there is some convergence. I mean, insurance companies want to cross into banking, and I just wonder really, don't we have a competitive system? I mean, it may be complicated externally, but it seems to be competitive. And whether insurance executives really want to be in banking, I don't know. I mean, somebody who may be a good insurance customer may not be the best banking customer, and vice versa. And I just wonder about that premise.

HON. PETER FISHER: There's no doubt that we have among the most robustly competitive financial services industries in the world. Nothing I've said today should take anything away from that. I think you were here earlier when we had a question from over here, what's in it for us? Arbitrage is very profitable. I offer that. I think there is yet some evidence that the system is not as efficient and pro competitive as it might be. And I think, you know, there's almost any topic, you could open almost any page of the relevant volumes of U.S. Code or various regs, and almost randomly put your finger on a page, and I bet you could come up with margining rules and how different they are in different products. So I take your point. We have a wonderfully competitive system.

I think that our regulatory process to pride itself on how archaic and out-of-date it is, and how verging on irrelevant it is for where the industry is going, is not something that would come very easily to an Under Secretary for Domestic Finance.

* Hon. Peter R. Fisher is the Under Secretary for Domestic Finance, United States Department of the Treasury. His remarks made up the luncheon address of the Federalist Society's 4th Annual Financial Services Conference on October 11, 2002 at the Rayburn House Office Building.

Free Speech & Election Law

Shakedown in 'The Golden State'?

*By Eric Schippers**

More than 150 years after gold was first discovered at Sutter's Mill in California, a new Gold Rush has begun in that state, fueled by the shameless exploitation of one of the most powerful consumer protection laws in the nation. Trading in their pick axes and mules for law degrees and monogrammed briefcases, today's prospectors are trial lawyers who are panning for gold along the shores of endless streams of unsuspecting businesses.

In 1933, the California Legislature enacted the landmark Unfair Competition Law (UCL), better known as Section 17200 of the Business and Professions Code, to allow public prosecutors and private citizens (acting for themselves or on behalf of the public as "private attorneys general") to file lawsuits to protect businesses from the unfair business practices of competitors. By the late 1970s, legislative amendments gradually expanded the law to protect consumers from any "unlawful, unfair or fraudulent business act or practice" and any "unfair, deceptive, untrue or misleading advertising."

State courts, in refusing to narrowly define what constitutes an "unfair business practice," have generally given free reign to 17200 actions, allowing the statute to be applied in almost any context. If found guilty under Section 17200, a business can be forced to disgorge all monies acquired by means of any unlawful actions.

While originally intended to protect both businesses and consumers, Section 17200, in combination with the state's "private attorney general" provisions — which allow for attorneys' fees to be paid to winning lawyers — have become a mother lode for trial lawyers looking to strike it rich, evidenced by the fact the state trial lawyers' association reportedly held a how-to conference last year on 17200 claims.

Under the enormously broad UCL, any private attorney can independently sue a business without needing a client or any evidence showing someone has actually been deceived or harmed. A suit can be brought even if the alleged misconduct has already been investigated and/or remedied by the attorney general, district attorney or a regulatory agency.

In addition, separate 17200 suits can be brought against the same defendant by a multitude of law firms, all acting as "private attorneys general," all seeking to hit pay dirt. In fact, once word gets out that a defendant has settled a 17200 suit, a pile-on will typically ensue with the furious filings of duplicative suits.

While a trial lawyer suing under Section 17200 is not entitled to punitive damages, unfair competition claims are often added to existing lawsuits to raise the prospects of a larger payout at the settlement table.

Over the last several years, hundreds of "representative action" lawsuits have been filed in California against thousands of business owners. Big ticket 17200 suits have been launched against the tobacco companies, the maker of the diabetes drug Rezulin, the Kaiser Foundation Health Plan, and sports equipment manufacturer Nike Inc.

The lawsuit against Nike exemplifies how the UCL can be hammered and forged into a mighty sword against deep-pocket corporations. In 1998, California anti-business activist Marc Kasky filed an unfair competition claim alleging the company's public statements in defense of attacks against its overseas labor practices constituted false or misleading advertising.

The trial court and court of appeals ruled that even if Nike's communications — including press releases and letters to newspaper editors — were assumed to be false, the First Amendment protected the statements because they did not promote a particular product, but were part of a general discussion concerning a matter of public interest and public debate.

The California Supreme Court reversed (4-3), characterizing Nike's messages as "commercial speech," a designation that stripped Nike's statements of their full First Amendment protections and placed them in the same category as the company's explicit product advertisements.

The U.S. Supreme Court will review the decision on appeal and issue its opinion this term. If allowed to stand, the *Nike* ruling will have a profoundly chilling effect on the free speech rights of all corporations, regardless of where they are based or where they speak. Nike, which is based in Oregon, was accused, in part, of making false statements which appeared in the *New York Times*, but were distributed in California.

While high profile 17200 suits, like the one against Nike, are often splashed across newspaper headlines and invoke the services of prominent attorneys for the defense, such as Harvard Law Professor Laurence Tribe and former Acting Solicitor General Walter Dellinger, the majority of unfair competition suits filed in California are against small and ethnic- or immigrant-owned "mom-and-pop" businesses. These are the stories one seldom hears.

Hard at work in pursuit of the American dream, these small business owners are less likely to be able to afford an attorney, thus they're less likely to know their rights and more likely to pay out-of-court settlements.

Take for example the frivolous 17200 lawsuits filed against hundreds of Vietnamese nail salon owners in Southern California by the law firm of Brar & Gamulin. According to the firm's complaint, the salons are "unlaw-

fully" using the same bottle of nail polish on multiple customers. Never mind that the State Board of Barbering and Cosmetology regards reusing the same bottle of polish as standard industry practice.

"I've never had any complaints from customers, and the state board has never fined me or cited me," complained Mindy Le, owner of Express Nails to the *Orange County Register*. Lawyers at Brar & Gamulin — supposedly working on behalf of the general public — are reportedly willing to quietly settle the matter for anywhere from a few hundred dollars to a thousand dollars per salon.

Welcome to the land of organic milk and cruelty-free honey. Who needs a baseball bat when Section 17200 works so well in separating an easy mark from his money?

Then there's the case of Malcolm Smith, owner of a motorcycle shop in Riverside, who is being sued by a Beverly Hills law firm, Trevor Law Group, and a one-man for-profit group called "California Watch Enforcement Corp." for abbreviating the words "on approved credit" (O.A.C.) in a print advertisement. Smith tells the *Press Enterprise* he got a letter from the Trevor lawyers saying they'd accept $5,000 to settle the matter.

According to the *Associated Press*, an attorney for Trevor Law Group acknowledged at a recent legislative hearing that California Watch — which conveniently shares the same address as the Trevor Group — receives its income "solely" from 17200 legal settlements.

Last year, the Trevor firm and California Watch sued more than 2,000 auto-repair shops in California, alleging unfair business practices under Section 17200. Many of the suits were based on minor technical or administrative violations of the Automotive Repair Act that were posted on the Bureau of Automotive Repair's website as "confirmed violations."

One company being sued has taken its anger out on the Bureau of Automotive Repairs, a state consumer agency. According to a complaint filed by Caliber Collision Centers, a collision repair company, the Bureau is engaging in "unlawful" practices by issuing citations for alleged violations of the Automotive Repair Act without the proper regulatory authority to do so. In addition, the suit argues that the Bureau is violating the due process rights of those accused by not giving them an opportunity to contest the alleged violations before the Bureau posts them on its website.

Like ants following a trail of breadcrumbs to a picnic, the Bureau's website, which is often outdated, has led hungry trial lawyers to a bountiful list of potential 17200 targets.

More and more, eerily similar horror stories coming out of the small business community are becoming impossible to ignore. In January, State Assemblyman Lou Correa (D-Anaheim) held a public hearing in Santa Ana, where hundreds of people attended to compare notes on their own 17200 shakedowns.

California Attorney General Bill Lockyer and the State Bar Association, after repeated pleas by the business community, have agreed to look into the extortionist tactics of those who ply their trade on 17200 claims. Meanwhile, in the state legislature, reform efforts are once again underway despite historically stiff opposition from trial lawyers who argue the law must remain in place to protect consumers — an argument that is increasingly more difficult to make with a straight face.

Some of the ideas being discussed to fix the system include requiring a judge to review the validity of a 17200 claim before it's filed, or requiring 17200 cases to be brought as class actions. Assemblyman Robert Pacheco (R-Walnut) is sponsoring a bill that would require a 17200 suit to include an actual plaintiff who can show harm from the alleged unfair business practice.

The attorney general and state legislature must stand up to the trial bar and fight for true and meaningful reform of California's runaway tort system. As California Supreme Court Justice Janice Brown told the *Copley News Service*, 17200 claims have become "a means of generating attorney fees without any corresponding public benefit." Few other statutes in this country "confer the kind of unbridled standing to so many without definition, standards, notice requirements, or independent review."

It used to be that any two-bit thug wielding a law degree in a back alley could get some poor, unsuspecting mom-and-pop owner to fork over some cash. However, as with most "get-rich-quick" schemes of the past, someone usually gets too greedy and spoils it for everyone. Many a gold mine has come crashing down on an overeager prospector who dug too far, too fast. In the case of Section 17200, there is no way to hide the mountains of frivolous lawsuits being filed by unscrupulous trial lawyers and anti-business activists, all too hungry for a piece of the action.

It's time for this California Gold Rush to be history.

* Eric Schippers is President of the Alexandria, Va.-based Center for Individual Freedom Foundation, www.cfif.org.

Nike v. Kasky: An Invitation to Discard the Commercial Speech Doctrine

*By Deborah J. La Fetra**

Over the past 60 years, this Court's approach to speech uttered by business interests has ranged from zero protection (*Valentine v. Chrestensen*, 316 U.S. 52 (1942)), to very high protection (*Virginia State Bd. of Pharmacy v. Virginia Citizens Consumer Council, Inc.*, 425 U.S. 748 (1976)), to a four-part test (*Central Hudson Gas & Elec. Corp. v. Public Serv. Comm'n*, 447 U.S. 557, 564 (1980)), which has itself undergone revision (*Board of Trustees v. Fox*, 492 U.S. 469, 480 (1989) (upholding a regulation outlawing Tupperware parties on a university campus)). There have been conflicting analyses depending on the speaker (*Bates v. State Bar*, 433 U.S. 350, 384 (1977) and *Ohralik v. Ohio State Bar Association*, 436 U.S. 447, 456 (1978) (lesser protection accorded to attorney solicitations)) and the social worth of the activity promoted (*Compare Posadas de Puerto Rico Assocs. v. Tourism Co.*, 478 U.S. 328, 342, 348 (1986) (restrictions on advertisements for legal gambling facilities do not violate the first amendment) *with Schaumburg v. Citizens for a Better Environment*, 444 U.S. 620, 632 (1980) (restrictions on solicitations for charity struck down)).

In *Central Hudson Gas & Electric Corp. v. Public Service Commission of New York*, 447 U.S. 557, 566 (1980), the Supreme Court formulated a four-part test against which restrictions on commercial speech would be weighed:

> For commercial speech to come within [the First Amendment], [1] it at least must concern lawful activity and not be misleading. Next, we ask [2] whether the asserted governmental interest is substantial. If both inquiries yield positive answers, we must determine [3] whether the regulation directly advances the governmental interest asserted, and [4] whether it is not more extensive than is necessary to serve that interest.

This Court later expanded *Central Hudson*'s inherent flexibility. *See e.g.*, *Board of Trustees of the State Univ. of New York v. Fox*, 492 U.S. 469, 480 (1989) (requiring a "reasonable fit" rather than the least restrictive means to comply with the fourth prong). Unfortunately, this flexibility has "left both sides of the debate with their own well of precedent from which to draw," Floyd Abrams, *A Growing Marketplace of Ideas*, Legal Times, July 26, 1993, at S28.

The commercial speech doctrine has become nearly impossible to apply because "commercial speech" is often extremely difficult, if not impossible, to identify. This Court has long recognized that speech can serve dual functions.

> [M]uch linguistic expression serves a dual communicative function: it conveys not only ideas capable of relatively precise, detached explication, but otherwise inexpressible emotions as well. In fact, words are often chosen as much for their emotive as their cognitive force. We cannot sanction the view that the Constitution, while solicitous of the cognitive content of individual speech, has little or no regard for that emotive function which, practically speaking, may often be the more important element of the overall message sought to be communicated.

Cohen v. California, 403 U.S. 15, 26 (1971). The duality of commercial and noncommercial speech becomes critically important when overlaid with the Supreme Court's treatment of false or misleading speech. Traditionally, in the realm of noncommercial speech, the government is restrained from acting as the arbiter of truth and falsity. *See, e.g., Police Dep't of Chicago v. Mosley*, 408 U.S. 92, 95 (1972) ("[T]he First Amendment means that government has no power to restrict expression because of its message, its ideas, its subject matter or its content."). Moreover, the state may not punish its citizens for disseminating false noncommercial information. *New York Times v. Sullivan*, 376 U.S. 254, 271-72 (1964) ("[a]uthoritative interpretations of the First Amendment guarantees have consistently refused to recognize an exception for any test of truth. . . . [E]rroneous statement is inevitable in free debate, and . . . it must be protected if the freedoms of expression are to have the 'breathing space' that they 'need . . . to survive.'"); *See also First National Bank of Boston v. Bellotti*, 435 U.S. 765, 777, 783 (1978) (corporations enjoy the same degree of constitutional protection as individuals for direct comments on public issues; thus, corporate sponsored editorials which address the merits of a pending legislation should not be subject to government regulation of falsity).

The divergent lines of commercial speech jurisprudence have produced a well of confusion, the most extreme example of which is the California Supreme Court decision in *Kasky v. Nike*, 27 Cal. 4th 939 (2002), now pending before the United States Supreme Court on a petition for a writ of certiorari. In a groundbreaking decision, the Court held that "when a court must decide whether particular speech may be subjected to laws aimed at preventing false advertising or other forms of commercial deception, categorizing a particular statement as commercial or noncommercial speech requires consideration of three elements: the speaker, the intended audience, and the content of the message." *Id.* at 960. The Court tries to downplay the nature of its holding, claiming that it merely means "that when a business enterprise, to promote and defend its sales and profits, makes factual representations about its own products or its own operations, it must speak truthfully." *Id.* at 946. There is, of course, nothing to prevent other courts from

considering this reasoning persuasive enough to depart from the consumer fraud context to which the court tries to limit it.

Dissenting, Justice Janice Brown took issue with the current commercial speech doctrine that is dependent on speech being categorized as *either* commercial or noncommercial, with little quarter given to speech that contains elements of both. *Id.* at 979 (Brown, J., dissenting). Contemporary marketing, she argues, involves speech far more intermingled than segregated: "With the growth of commercialism, the politicization of commercial interests, and the increasing sophistication of commercial advertising over the past century, the gap between commercial and noncommercial speech is rapidly shrinking." *Id.* She further laments, "I believe the commercial speech doctrine, in its current form, fails to account for the realities of the modern world–a world in which personal, political, and commercial arenas no longer have sharply defined boundaries." *Id.* at 980.

The speech in this case involved press releases, letters to the editor, letters to university athletic directors and the like describing Nike's overseas labor practices. Far from the prototypical commercial speech of offering to sell X product for Y price, Nike's speech sought to rehabilitate a corporate image as well as provide information to the public on a matter of broad concern. Extending the lesser protection of the commercial speech doctrine to this type of speech threatens a wide variety of public relations communication. For example, companies frequently use websites with a combination of sales pitch and general information about their products, industry, or related concerns. Music videos provide entertainment while hoping to encourage consumers to purchase the musician's CDs. Some companies even engage in "stealth marketing," in which they hire actors to use the products in public and say nice things about the products (such as digital cameras or a brand of liquor) to onlookers, but never letting on that they are in the hire of the company or explicitly urging anyone to buy the products.

The current commercial speech doctrine leads to highly unpredictable results. Pulling a little of this and a little of that from a variety of this Court's opinions, a majority of the California Supreme Court developed a new doctrine unlike any the Supreme Court–or any other court–ever articulated. When the state of the law reaches this point, affected parties have no means by which to adapt their actions or their speech to prevent themselves from running afoul of the law. This uncertainty chills protected speech as those fearing liability shy away from expression that might be construed as "commercial."

The Supreme Court has thus far resisted "breaking new ground," finding *Central Hudson* to be "adequate," (*e.g., Thompson v. Western States Medical Center*, 122 S. Ct. 1497, 1504 (2002); *Lorillard Tobacco v. Reilly*, 533 U.S. 525, 554-55 (2001)), but the ad hoc application of *Central Hudson* fails to provide the guidance necessary to a fair and even application of constitutional law. *See Lorillard*, 533 U.S. at 574 (Thomas, J., concurring in part and in the judgment) ("the Court has followed an uncertain course– much of the uncertainty being generated by the malleability of the four-part balancing test of *Central Hudson*."); *Rutan v. Republican Party*, 497 U.S. 62, 95-96 (1990) (Scalia, J., dissenting) (footnote omitted) ("When it appears that the latest 'rule,' or 'three-part test,' or 'balancing test' devised by the Court has placed us on a collision course with such a landmark practice, it is the former that must be recalculated by us, and not the latter that must be abandoned by our citizens.").

The Supreme Court's current commercial speech jurisprudence simply is not up to the task of analyzing corporate interests' innovative ways of informing the public of their positions on issues ranging from the companies themselves to raging public debates. The California Supreme Court's decision demonstrates how far afield a court can go while relying on Supreme Court precedents. The *Nike* decision cannot be reconciled with the First Amendment, but can serve only as authority for other courts to ratchet downward the protection due not only to commercial speech, but to any speech that has even the slightest element of commercial gain for the speaker.

* Deborah J. La Fetra is a Principal Attorney with Pacific Legal Foundation.

What Does Academic Research Tell Us About the Role of Money in American Politics?

*By Jeffrey Milyo**

Proponents of campaign finance reform argue that money plays a central and nefarious role in American politics. Even the most modestly informed citizen is familiar with the argument that campaign spending determines electoral outcomes, and that this forces candidates to sell out to moneyed interests, which in turn alienates the general public. Consequently, even though more stringent campaign finance regulations may impinge on certain freedoms, so the familiar argument goes, such laws are necessary to restore a healthy democracy. Opponents of reform take issue with this last point, but rarely challenge the premises that underlie the reformers case. However, each element of this argument — that money drives electoral outcomes, contributions are like bribes, voters are alienated by the role of money in politics and campaign finance reforms will improve the workings of democracy — are either contradicted or unsubstantiated by decades of scholarly research.

Perhaps in no other area of public policy are political and legal decisions made in such complete ignorance of the basic facts and findings of relevant research. For example, in the last decade, increased campaign spending at the Federal level has been associated with more political competition, increasing trust in government, and no decrease in voter turnout. These simple trends run counter to the familiar claims about money in politics, but more importantly, so do the findings of more sophisticated analyses. Below, I summarize some of the lessons for reform from academic research on the influence of money in elections, policymaking and perceptions about the legitimacy of government.

Political Competition

Every two years, public interest groups and media pundits lament the fact that winning candidates in the national elections typically far outspend their nearest competitor. From this, it is inferred that campaign spending drives electoral results, and in turn follow a host of other perceived ills with American democracy. Given the importance of the claim that campaign spending determines electoral fortunes, it is shocking that so many legal and political analysts are unaware that decades of social science research reach the opposite conclusion.

Most studies of the electoral effects of campaign spending examine House or Senate elections. No such study has ever found more than only modest effects of campaign spending on the prospects of candidates. Of course, the state of knowledge in social science is not best measured by counting studies with one result or another, but by focusing on the most sophisticated studies and ignoring those that are rife with logical errors. After screening for high quality analyses of elections, the typical finding is that the marginal effects of campaign on the probability that a candidate wins are statistically indistinguishable from zero.

How can this be so? The best explanation to date is that competent candidates are adept at both convincing contributors to give money and voters to give their vote. Consequently, the finding that campaign spending and electoral success are highly correlated exaggerates the importance of money for a candidate's chances of winning. In order to isolate this causal relationship, social scientists hunt for quasi-experiments that isolate the treatment effect of campaign spending. For example, Senator Corzine (D-NJ) was elected to the Senate in 2000, after defeating a weak Republican opponent and spending over $60 million of his own personal fortune. While this episode was widely cited as an instance of the ability of wealthy candidates to buy a Senate seat; in fact, it illustrates the opposite.

Despite his record campaign spending, Corzine ran behind the average House Democrat in New Jersey and behind the Democratic nominee for president, Al Gore, despite the fact that Gore did very little campaigning in the strongly Democratic state. There is even some evidence that Corzine's wealth was a liability, given that many yard signs urged his Republican opponent to "make him spend it all!" This anecdote illustrates a more general finding: wealthy candidates for office tend to fare no better than other candidates, all else constant. This is because the ability to spend out of one's own personal fortune is unrelated to the ability to appeal to voters.

Related findings abound. For example, large campaign war chests carried over from the previous election do not deter challengers and confer no electoral advantage to incumbents. Similarly, large fund-raising windfalls attributable to a change in committee assignment, or changes in campaign finance laws have been shown to be unrelated to candidates' electoral fortunes. Nevertheless, no serious scholar would argue that campaign spending is unimportant. These findings do not imply that anyone running for elective office would do as well spending several million dollars as not. Instead, the appropriate conclusion is that for any political race between two candidates, the outcome of that race would not be different had one of those candidates been able to spend a few hundred thousand dollars more (or less) than they actually were able to spend.

Another caveat is in order; studies of Federal elections are not informative of the effects of different campaign finance regulations, since there have been so few important changes to Federal law (until recently). How-

ever, there is considerable variation in campaign finance laws across states and even over time within states. This variation provides a laboratory for analyzing the effects of various regulations on electoral outcomes. For example, states with public financing of elections have fewer unopposed incumbents and more minor party candidates. However, public financing does not reduce the re-election rates of incumbent legislators or governors, so can not be said to increase political competition in that sense. In contrast, limits on campaign contributions from organizations (e.g., business and labor unions) are associated with increased turnover among state incumbents, while limits on individual contributions have the opposite effect. However, once limits on contributions are in place, small changes in the limits themselves are not associated with any changes in electoral competition in state races.

Nearly thirty years of academic research on campaign spending points to one conclusion; money is not the driving force in American elections, and most campaign finance regulations are not associated with increased political competition. The one exception to this is the finding that limits on contributions from organized interests are associated with more competitive state races. This might suggest that the new prohibition on soft money will increase political competition, but limits on contributions to parties are not the same as limits on contributions to candidates. Political parties allocate their resources strategically to maximize the number of winning candidates from the party. To the extent such additional resources help candidates win votes, the soft money prohibition may reduce competition at the Federal level. However, if previous research is to be believed, the loss of soft money should have no noticeable effect on the competitiveness of Federal elections.

Policy Consequences

Are campaign contributions the functional equivalent of bribes? The conventional wisdom is that donors must get something for their money, but once again decades of academic research on Congress has failed to uncover any systematic evidence that this is so. Indeed, legislators tend to act in accordance with the interests of their donors, but this is not because of some quid pro quo. Instead, donors tend to give to like-minded candidates. Of course, if candidates choose their policy positions in anticipation of a subsequent payoff in campaign contributions, this is a distinction without a difference. However, studies of legislative behavior indicate that the most important determinants of an incumbent's voting record is constituent interests, party and personal ideology. In election years, constituent interests become more important than in non-election years, but overall these three factors explain nearly all of the variation in incumbent's voting records.

Most informed citizens react to these findings with incredulity. If campaign contributions don't buy favors, then why is so much money spent on politics? In contrast, scholars of American politics have been trying for decades to disabuse the public of this misconception. In addition to the studies described above, consider that large firms spend 10 times more on lobbying than on campaign contributions (from affiliated PACs, individuals or soft money). In addition, political expenditures by firms tend to be a fixed proportion of net revenues and do not rise and fall as relevant issues move on or off the policy agenda. Neither of these facts is easily reconciled with the notion that campaign contributions are the functional equivalent of bribes. Of course, neither does this imply that campaign contributions are completely inconsequential, only that the conventional wisdom overstates the importance of contributions.

One concern with these studies is that evidence of the policy consequences of campaign contributions may not be manifest in the roll-call votes of legislators. Scholars have long recognized that the relevant action may take place behind closed doors, where the content of legislation is determined. This is a much more difficult proposition to test, but at least one recent study has found no relationship between campaign contributions and the activities of legislators within committees. More convincing would be evidence that states with more laissez-faire campaign finance regulations adopt substantively different policies. Unfortunately, to date, no such study has been conducted. However, the experience of California politics may contradict the claim that campaign contributions buy policy favors for moneyed interests. Until recently, California placed no limits on the size or source of campaign contributions to candidates for state office; however, for decades California has produced some of the most progressive state policies.

Nevertheless, systematic investigation of the policy consequences of campaign finance laws should be a high priority for future academic research.

Legitimacy of Government

The nefarious role of money in politics is often cited as the reason for low voter turnout and a lack of trust in government in America. To be sure, if you lived in a superficially democratic society where the wealthy or well-connected can effectively buy policy or even buy elective office, who could blame you for becoming disaffected? Popular wisdom holds that campaign finance is the cure for political corruption and voter alienation; once again, there is little evidence to support this oft-repeated claim.

The relationship between campaign finance and legitimacy has received very little attention from social scientists. For example, there have been no studies of the relationship between political corruption and state campaign finance laws, nor have there been any studies of the relationship between campaign finance laws and either trust in government or voter turnout. Nevertheless, other evidence suggests that it is doubtful that campaign

finance reform will affect either trust or turnout. For example, campaign spending is associated with both more informed voters and higher turnout. This suggests that limits on campaign spending may have the unintended consequence of reducing voter participation. Further, surveys of voter and non-voters reveal that the decision to vote is unrelated to opinions about the role of money in politics or the legitimacy of government. Instead, non-voters are simply less likely to view voting as an important duty.

There is an on-going debate about whether negative campaign advertisements reduce voter turnout, but most studies now find no such relationship. In addition, there is no evidence that negativity is associated with either increased campaign spending, nor is there any evidence that campaign finance reforms will influence the tone of campaigns. However, the question of whether campaign tone influences trust in government has not yet been studied.

Conclusion

Political and legal decision makers have for too long considered the role of money in politics to be self-evident; this has led to a widespread and pervasive misunderstanding of the likely costs and benefits of campaign finance reform proposals. But political institutions are no less subject to scientific inquiry than are social or economic institutions. The consensus among academic researchers is that money is far less important in determining either election or policy outcomes than the conventional wisdom holds. To be sure, more attention has been given to the role of money in elections that to other relevant questions. But the argument for reform unravels if campaign spending does not determine electoral outcomes. Given that campaign spending has so little impact on elections, it follows that limited campaign contributions to candidates do not elicit much in return. Further, since campaign contributions are for the most part inconsequential, policy outcomes are not distorted by moneyed interests. Further, to the extent that citizens have some sense of these realities, campaign finance reforms are also unlikely to improve the perceived legitimacy of government.

There is even some reason to be concerned that ill-considered reforms will have important unintended consequences. For example, limits on individual contributions are associated with reduced political competition, which is in turn associated with reduced turnout. Further, exposure to campaign advertising makes voters more knowledgeable about candidate positions, which is not only desirable itself, but also associated with increased voter turnout.

* Jeffrey Milyo is an assistant professor in the Irving B. Harris School of Public Policy Studies at the University of Chicago.

International & National Security Law

Domestic Courts and Growing NGO Investment in "International Law": At What Cost and Consequence to Democracy?

*By Donald J. Kochan**

Introduction

Increasingly, United States courts are recognizing various treaties, as well as declarations, proclamations, conventions, resolutions, programmes, protocols, and similar forms of inter- or multi-national "legislation" as evidence of a body of "customary international law" enforceable in domestic courts, particularly in the area of tort liability. These so-called "legislative" documents, referred to herein as customary international law outputs ("CILOs"), are seen by some courts as evidence of *jus cogens* norms that bind not only nations and state actors, but also private individuals. Such enforceability has occurred even where such international CILOs have not been codified or otherwise adopted by Congress.

The most obvious evidence of this trend is in the proliferation of lawsuits against corporations with ties to the United States for alleged violations of customary international law during development projects abroad. Such lawsuits are most often brought under the federal Alien Tort Statute ("ATS"), 28 U.S.C. § 1350, which has seen an evolution in the past 22 years after remaining dormant for nearly 200 years since its passage with the Judiciary Act of 1789. The evolution began in 1980 when the ATS was raised from dormancy and a federal appeals court found that suits based on customary international law for human rights abuses could be heard under the ATS.[1] Use of the ATS expanded most notably again in 1995 when a federal appeals court held that quasi-public and even private actors might be bound by customary international law;[2] and grew again in 1997 when a federal district court held that a private corporation was subject to ATS jurisdiction for alleged human rights abuses abroad.[3] Since then, scores of lawsuits against private actors – principally corporations engaged in natural resources development – have been filed. The September 18, 2002 decision by the U.S. Court of Appeals for the Ninth Circuit in *Doe I v. Unocal Corp.*, 2002 WL 31063976 (9th Cir. Sept. 18, 2002), is the latest, greatest expansion of the ATS to allow customary international law tort suits against private actors.

There are several problems with this trend toward enforceability of "customary international law" in U.S. courts. The litigation trend has many infirmities related to the Constitution, foreign policy, national security, and the public policies supporting economic development and its concomitant effect on the advance of democracy and political liberty.[4]

But this essay focuses on the consequences of enforceability of these CILOs arising from four interrelated factors: (1) the lack of bicameralism and presentment associated with the development of the documents associated with this judicially recognized body of customary international law – a process that increases the cost for the production of legislation and thereby checks rent-seeking; (2) the lack of formal elements of law associated with such documents – whereas more formal, specific, and knowingly enforceable legislation is more difficult and expensive for an interest group to produce; and, thus, formality requirements to enforceability decrease production of laws while looser standards are cheaper and more easily produced; (3) unequal expectations of the parties in the bargaining process for the production of such documents – meaning that the parties have not and are not now always cognizant of both the benefits and costs of customary international law document production because enforceability was either unexpected or unknown; and (4) the resulting incentives for nongovernmental organization ("NGO") rent-seeking from international bodies and development of such documents due to an increased value to such documents directly proportional to increased judicial enforceability.

Cutting Congress Out of the Bargaining Process

Many of the documents upon which courts are relying to identify customary international law and which NGOs are using in court to attempt to establish liability have not been acknowledged as binding let alone passed as law by Congress. As James Madison articulated, "[N]o foreign law should be a standard farther than is expressly adopted."[5]

For example, using two Second Circuit decisions – *Filartiga*[6] and *Kadic*[7] – as illustrations, each court looked to various international declarations and resolutions, including the Universal Declaration on Human Rights, to interprete the scope of the "law of nations" under the ATS. Such references create two problems. First, many of the sources relied, or at least partially relied, upon to determine a controlling rule of international law have never been ratified by Congress. Worse yet, Congress considered these declarations and resolutions and specifically chose not to accept them as binding authority. This poses serious questions about the legitimacy of their use as sources of law. In *Filartiga*,

> [T]he Second Circuit alluded to certain international treaties on human rights, including the American Convention on Human Rights, the International Covenant on Civil and Political Rights, and the European Convention for the Protection of Human Rights and Fundamental Freedoms. The first two of these were among the four treaties on human rights submitted by President Carter to the Senate for its advice and consent in 1978 [and the United States

> was not involved in the third]. Neither in the court's opinion nor in the amicus brief filed in the Filartiga case jointly by the Departments of Justice and State, was reference made to the reservations, declarations, understandings, and statements that President Carter recommended that the Senate include in its resolution of advice and consent. The effect of these qualifications of the two treaties would be to render them non-self-executing for the United States, requiring implementing legislation to become effective as law in the United States.[8]

The *Filartiga* court did not even discuss or recognize either Congress's failure to ratify these documents or the affirmative and explicit concerns voiced by both Congress and the President in relation to the content of these documents. Yet it seems clear, especially in light of Congress's power to define offenses against the law of nations, that these sentiments should restrict the courts' reliance upon such documents as an authoritative statement of the law.[9]

Congress's actions on the International Covenant on Civil and Political Rights,[10] the American Convention on Human Rights, or on the Universal Declaration of Human Rights are not isolated situations. In fact, Congress has failed to ratify the vast majority of human rights treaties sponsored by the United Nations.[11] This record indicates a general unwillingness on the part of the United States to recognize broad principles of human rights as controlling legal authority.[12] For the courts to ignore this reality and insist that these documents form a foundation for ascertaining the "law of nations" component of the ATS is to harm Congress in two ways. First, it ignores Congress's power and prerogative to refrain from codifying certain principles or norms into U.S. law. Second, it restricts congressional power to legislate in a manner contrary to these principles or norms. By proclaiming that this principle or norm is universal and binding upon all states (or, in the case of *Kadic*, all states and some individuals), the court is stating that an obligation Congress has been specifically unwilling to accept will now bind the United States and its Congress.

Lacking Formal Elements of Law and An Expectation of Non-Enforcement by Some Bargaining Parties

Many of these CILOs are merely aspirational commitments between nations, not specific obligations for public or private entities with the formal elements of law. These types of documents are normally drafted with an understanding that they will not act as law, as evidenced by their language being far less precise and much broader than any signatory might normally wish to embody in a statute. Relying on proclamations of international assemblies creates problems because the texts of these documents are liberally drafted and embody general goals or aspirations as opposed to legally binding principles.[13] *Filartiga, Kadic*, and other cases applying the ATS, however, have looked to such documents as supporting authority for their pronouncements on the existence of an international law.[14]

Often the parties drafting the CILOs upon which the courts increasingly rely and upon which NGOs advocate in court simply did not intend for these documents to be construed as law. For example, Rusk has stated that "[t]he simple fact is that this [Universal] Declaration [of Human Rights] was not drafted or proclaimed to serve as law."[15] In fact, Eleanor Roosevelt, Chairman of the Commission on Human Rights, stated when presenting the Declaration to the U.N. General Assembly, that "[i]t is not and does not purport to be a statement of law or of legal obligation ... [it is] a common standard of achievement ...."[16] Rusk further contends that this was the understanding of Congress, the Executive, and even the United States delegates to the United Nations:

> As one of the authors of the instruction that Mrs. Roosevelt received from her government on this point, I can report that there was no question in Washington or in New York that the Universal Declaration was not intended to operate as law. There was no serious consultation with the appropriate committees or Congress, as would have been essential had there been any expectation that law was coming into being. Indeed, Mrs. Roosevelt was given great leeway in her part in the drafting of the Declaration partly because it was understood that law was not being created.[17]

The Universal Declaration of Human Rights is but one example. Had the drafters intended for many of these documents upon which courts and plaintiffs are relying to become legally binding in the judiciary, many of these documents might not have passed out of the multinational body, might not have been signed by the United States, and had they been accepted in some form, would surely exhibit a dramatically different language and scope than those promulgated with an understanding that the document was merely aspirational. As Rusk has stated, "It should be noted . . . that votes cast [on UN General Assembly Resolutions] with the knowledge that the result will not be law are very different from votes that would be cast if there were a general awareness that the result would be operationally and legally binding."[18]

This conclusion, that universal declarations are not meant to act as controlling law, is strengthened by an examination of the bodies creating these documents. Realizing that the United Nations is to have no sovereign authority, Rusk articulates the nature of its "power" as understood by member states:

> The [UN] Charter . . . did not contemplate that the General Assembly would be a legislative body in the field of international law generally. . . . There is little doubt that a general legislative power vested in the General Assembly would have prompted the Senate of the United States to refuse advice and consent to the Charter.[19]

Thus, even if Congress could delegate its power to define offenses against the law of nations to this international body, it clearly did not intend to do so. Similarly, other multinational organizations to which the United States is a party lack a gen-

eral legislative power. They may have the ability to draft treaties, but even these do not become binding upon the United States unless two-thirds of the Senate chooses to give its advice and consent to the ratification of that treaty.[20] Moreover, even when Congress ratifies a treaty, it may often require additional legislation to "execute" provisions of the treaty.[21]

The Increasing Role of NGOs and Its Implications

This essay concludes by discussing the incentives for, and influences of, NGOs in this process. It concludes that, from a public choice perspective, most CILOs should not serve as evidence of judicially enforceable legal obligations.

The examination focuses largely on the supply and demand for production of CILOs, arguing that enforceability of CILOs in U.S. courts in the short run should increase the production of CILOs. The thesis is that non-enforceability of CILOs was a significant demand constraint on production. Increasingly this constraint is being removed as more and more courts recognize CILOs as enforceable in U.S. courts – all without a corresponding increase in supply constraints.

For example, NGOs have a considerable advantage in bargaining for CILOs because the development of these documents lacks the interest group competition that keeps rent-seeking in check – *e.g.*, to date, globalization and international development lobbies have a noticeably lesser presence during production of customary international law documents, although with greater awareness this may be changing. The NGO advantage is further buttressed by the fact that the decision makers in the bargaining process: (a) did not or do not now approach the bargaining process as though the resulting standards would be enforceable; and (b) among themselves do not face equal burdens (e.g., not all nations or their constituents have equal risk of adverse consequences of enforcement of the international standards in a domestic court).

NGOs have taken note of, and exploited the possibilities in, this judicial trend. First, NGOs appear to be recognizing the benefits to their agendas that can be gained through tort litigation based on customary international law. It is no coincidence that anti-globalization, environmental, sustainable development, labor rights, and other human rights NGOs are the principal parties spearheading recent lawsuits on behalf of plaintiffs who have allegedly suffered as a result of development projects in underdeveloped and developing countries.[22] These NGOs have also found an ally in the domestic plaintiffs' bar – including some of the most influential trial lawyers from the tobacco, asbestos, breast implant, and other high profile mass tort suits of late – who are often partners in this emerging body of lawsuits.[23] The theories advanced in these suits appear not only to be attempts to take advantage of the increased recognition of customary international law but also to drive the law forward to further shape federal law as embracing a broad body of federally recognized international torts. Aside from developing law and resolving particular cases, NGOs are also taking advantage of such litigation and the threat thereof to pressure corporations to accept and adopt industry-wide international standards for certain activities. It will be interesting to discover whether these industry commitments will be revocable at some point in the future or if they may indeed inform (and accelerate) the development of customary international law further, legally binding industries to such standards in future litigation.

Second, the greater the chance that international "legislative" documents will create domestically enforceable norms in United States courts, the greater incentive NGOs have to invest in the development of CILOs. NGO investment in developing CILOs should be expected to increase as the documents' values are increased as a result of domestic court recognition of liability for conduct contrary to the standards contained therein.

Through production of CILOs and judicial enforceability, NGOs can not only subvert bicameralism and presentment for the creation of federal tort law but they might also achieve something perhaps more valuable – a declaration by a United States court of a universal law binding on all nations, including the United States, without surviving the rigors of bicameralism and presentment or constitutional amendment. Inherent in Congress's power to legislate is the authority to choose not to legislate. When a court decides to look beyond Congress for controlling regulations or for controlling definitions of "law", it may be usurping Congress's power to refrain from regulating or defining.[24] Stated another way, the court may create a regulation or definition where Congress clearly wishes to refrain from regulating or refrain from creating a controlling rule of law.[25]

At the same time that these demand constraints are weakened as a result of greater enforceability of CILOs, it is quite possible that supply constraints will remain stable, or at best tighten slowly. For one thing, NGO capture of CILO production centers – often single purpose units with longstanding relationships with NGOs – has meant that there is limited competition in the production process. The lack of serious opposition from diffuse interests means that increasing demand from NGOs for CILO production will not significantly checked – at least not in the short run. Although corporations and others subject to potential liability from enforceable CILOs may recognize that they need to become engaged opposition interest groups in the supply of CILOs, several barriers including entrenched capture will make it difficult for such groups to operate as a serious constraint on increased supply that will be motivated by increased demand.

Conclusion

As courts accord greater weight to customary international law outputs as establishing norms enforceable in litigation, many, including NGOs, will have an incentive to push for the production of CILOs that embody the principles that advance their interests. In the absence of courts stemming the tide toward CILO enforceability, Congress may have to affirmatively act to deliver a clearer signal to courts that certain CILOs not adopted into law by Congress must not be deemed so adopted by the courts.

* Donald J. Kochan is a Visiting Assistant Professor of Law at George Mason University School of Law.

Footnotes

[1] In *Filartiga v. Pena-Irala*, 630 F.2d 876, 877 (2d Cir. 1980), Dolly Filartiga, a citizen of the Republic of Paraguay, brought suit against Americo Norberto Pena-Irala, formerly an Inspector General of Police of Paraguay, for allegedly kidnaping, torturing, and killing her brother while holding that office. The alleged action took place in Paraguay. The district court dismissed the action for lack of subject matter jurisdiction. The Second Circuit reversed and remanded, holding that deliberate torture by state officials violates international law, and that alleging such torture creates jurisdiction under the ATCA. The Second Circuit held that courts ascertaining the law of nations "must interpret international law not as it was in 1789, but as it has evolved and exists among the nations of the world today." *Id.* at 881.

[2] Kadic v. Karadzic, 70 F.3d 232 (2d Cir. 1995), *reh'g denied*, 74 F.3d 377 (2d Cir. 1996), *cert. denied*, 116 S. Ct. 2524 (1996).

[3] Jon Doe I v. Unocal Corp., 963 F.Supp. 880 (C.D. Cal. 1997) (upholding subject matter jurisdiction under ATCA based on allegations that an American oil company, acting in concert with the Burmese government, committed various civil and human rights abuses), *aff'd in part & rev'd in part*, ___ F.3d ___, 2002 WL 31063976 (9th Cir. Sep 18, 2002).

[4] *See, e.g.*, Donald J. Kochan, *Constitutional Structure as a Limitation on the Scope of the "Law of Nations" in the Alien Tort Claims Act*, 31 Cornell Int'l L.J. 153 (1998); Donald J. Kochan, After Burma," Legal Times, Aug. 21, 2000, at 54; Donald J. Kochan, "Foreign Policy, Freelanced: Suits brought under Alien Tort Claims Act undermine federal government's authority," The Recorder (Cal.), Aug. 23, 2000, at 5; Donald J. Kochan, "Rein in the Alien Tort Claims Act: Reconstituted Law of Nations Standard Needs Defining by Congress," Fulton County Daily Report (Ga.), Aug. 24, 2000.

[5] 2 The Records of the Federal Convention of 1787, at 316 (Farrand ed., 1986).

[6] Filartiga v. Pena-Irala, 630 F.2d 876, 881 (2d Cir. 1980).

[7] Kadic v. Karadzic, 70 F.3d 232 (2d Cir. 1995), *reh'g denied*, 74 F.3d 377 (2d Cir. 1996), *cert. denied*, 116 S. Ct. 2524 (1996).

[8] Dean Rusk, *A Comment on Filartiga v. Pena-Irala*, 11 Ga. J. Int'l & Comp. L. 311, 315 (1981) (citations omitted). Hassan provides a similar conclusion:

> [T]he President also inserted various reservations, declarations and understatings [sic], thereby further decreasing the efficacy of those treaties [including the International Convention on the Elimination of All Forms of Racial Discrimination; the International Covenant on Economic, Social and Cultural Rights; the International Covenant on Civil and Political Rights; and the American Convention on Human Rights], quo the USA, when eventually those treaties are ratified by the USA.

Farooq Hassan, Note, *A Conflict of Philosophies: The Filartiga Jurisprudence*, 32 Int'l & Comp. L.Q. 250, 255 (1983) (also adding that the Genocide Convention, submitted to the Senate in 1948, has still not been ratified).

[9] *See* Mark P. Jacobsen, Comment, *28 U.S.C. 1350: A Legal Remedy for Torture in Paraguay?*, 69 Geo. L.J. 833, 834, 849 (1981) (arguing that, "the court might have effectively curtailed the Senate's ability to set policy in the area of human rights.").

[10] The International Covenant on Civil and Political Rights awaited Senate action since 1978, *id.* at 847, eventually entering into force for the United States in late 1992 with five reservations, five understandings, four declarations, and one proviso. *See generally* John Quigley, Criminal Law and Human Rights: Implications of the United States Ratification of the International Covenant on Civil and Political Rights, 6 Harv. Hum. Rts. J. 59 (1993).

[11] Jacobsen, *supra* note 6, at 847-48 ("[T]he Senate has been unwilling to extend international law to encompass the protection of human rights.").

[12] *See id.* at 849. *See also* Curtis A. Bradley & Jack L. Goldsmith, *Customary International Law as Federal Common Law: A Critique of the Modern Position*, 110 Harv. L. Rev. 815, 869 (1997) (stating that "the political branches have made clear that they do not want the new CIL [customary international law]to have domestic law status").

[13] One court in a case where plaintiffs sought jurisdiction under the ATS, for example, granted *a Fed. R. Civ. P. 12(b) (1)* motion on the basis that the international principles relied upon, the Stockholm Principles on the Human Environment,

> do not set forth any specific proscriptions, but rather refer only in a general sense to the responsibility of nations to insure that activities within their jurisdiction do not cause damage to the environment beyond their borders. Nor does the Restatement of Foreign Relations law constitute a statement of universally recognized principles of international law.

Amlon Metals, Inc. v. FMC Corp., 775 F. Supp. 668 (S.D.N.Y. 1991).

[14] The *Filartiga* court cited as authority a number of international treaties, "to which the United States is not a party," to establish a universal norm against torture in modern usage and practice. Louis B. Sohn, *Torture as a Violation of the Law of Nations*, 11 Ga. J. Int'l & Comp. L. 307, 308 (1981).

[15] Rusk, *supra* note 5, at 313.

[16] *Id.* (quoting (XIX Bulletin, Dep't St. Bull., Dec. 19, 1948, No. 494, at 751)).

[17] *Id.* at 314.

[18] *Id.* at 315.

[19] *Id.* at 314.

[20] U.S. Const. art II, §2, cl. 2.

[21] This is the distinction between self-executing and non-self- executing treaties. *See* Tel-Oren v. Libyan Arab Republic, 726 F.2d 774, 808-19 (D.C. Cir. 1984) (Bork, J., concurring).

[22] *See, e.g.,* Robert Vosper, *Conduct Unbecoming; No Longer Satisfied With Destroying the Reputations of Corporations That Get Entangled in Human Rights Abuses Overseas, Activist Groups are Seeking Retribution in U.S. Courts*, Corp. Leg. Times, October 2002, at 35.

[23] *See id.* For example, Steve W. Berman, the attorney who represented over a dozen states in the tobacco litigation, was lead counsel for a group of Papua New Guinea residents who sued, among others, Rio Tinto PLC for abuses alleged in conjunction with its mining operations in Papua New Guinea. *See* Sarei v. Rio Tinto PLC, 221 F.supp.2d 1116 (C.D. Cal. 2002).

[24] *See* Arthur M. Weisburd, *State Courts, Federal Courts, and International Cases*, 20 Yale J. Int'l L. 1, 38-44 (1995).

[25] Arthur M. Weisburd, *The Executive Branch and International Law*, 41 Vand. L. Rev. 1205, 1255-56 (1988).

The Federalism Implications of International Human Rights Law

*By Christian G. Vergonis**

I. Introduction

The reemergence of judicially enforceable federalism may be the most significant doctrinal development of the Rehnquist Court.[1] Due principally to the reinvigoration of limits on the two cornerstones of modern congressional power—the Commerce Clause[2] and the Fourteenth Amendment's Enforcement Clause[3] —the Supreme Court, for the first time since the New Deal, has taken seriously the notion that the national government is one of enumerated powers that do not extend to matters of truly local concern.

The Court's current thinking in this area can be distilled into the following postulates: non-economic intrastate matters cannot be regulated by Congress under the Commerce Clause; such matters similarly cannot be regulated under the Enforcement Clause unless they amount to or threaten the violation of a Fourteenth Amendment right by a state actor. Together, these principles seemingly place large categories of local conduct beyond the regulatory reach of the national government.

But all may not be as it seems. It is unsurprising that judicial decisions limiting the scope of certain enumerated powers would prompt a search for other powers justifying the disabled regulatory authority. This is, after all, the history of the federal civil rights laws,[4] and the increasing frequency of cases involving the Enforcement Clause[5] is itself due in part to the federal government's efforts to justify under that provision what *Seminole Tribe* and *Lopez* prohibit it from doing under the Commerce Clause. And, in fact, the Supreme Court's recent federalism jurisprudence has coincided with other developments in the law that promise to give back to the national government much of what the Court's decisions have taken away.

The national government's foreign affairs power would seem an unlikely candidate for such an undertaking, given that the focus of such power (one would think) is on matters of national import and international relations, not local concern. Yet over the past several decades, all three branches of the federal government have adopted, somewhat uncritically, components of a modern, internationalist vision of human rights that allows for regulation, under federal law, of the relationships between individuals and their own governments and countrymen. With little fanfare, the groundwork has thereby been laid for a broad national power to protect individuals from misconduct, however local in nature, deemed by the government to violate international human rights norms.

This paper explains why those concerned with the structural elements of domestic federalism ought to care about these developments in international human rights law.[6] To do so, it focuses on the national government's putative power to incorporate international human rights norms into federal law. Part II describes the nature of international law and surveys the developments that have made international human rights norms enforceable within the U.S. legal system. Part III looks at the consequences of these developments with respect to the national government's power to regulate local activities that it cannot otherwise reach under the Supreme Court's recent federalism decisions. Finally, Part IV examines the constitutional issues surrounding the national government's use of its foreign affairs powers to protect human rights.

II. International Human Rights Law as Federal Law

To the domestic lawyer accustomed to dealing with the laws of particular jurisdictions, the concept of "international law" may seem somewhat obscure. According to the American Law Institute's Restatement of the Foreign Relations Law of the United States:

> "International law is the law of the international community of states. It deals with the conduct of nation-states and their relations with other states, and to some extent also with their relations with individuals, business organizations and other legal entities."[7]

There being no international lawmaking body, the rules of international law are derived from agreements between nations and from what is known as "customary international law," an unwritten body of norms that "results from a general and consistent practice of states followed by them from a sense of legal obligation."[8] Traditionally viewed solely as a tool for the resolution of disputes between consenting nations, international law expanded in the wake of the Holocaust to include norms designed to protect individual human rights, *i.e.*, the "freedoms, immunities, and benefits which, according to widely accepted contemporary values, every human being should enjoy in the society in which he or she lives."[9] Thus, it is now generally accepted by scholars and commentators that international law prohibits genocide, torture, racial discrimination, prolonged arbitrary detention and a variety of other abusive behavior, at least where practiced by state actors.[10] The second half of the twentieth century also saw the rise of the notion of peremptory or *jus cogens* norms, *i.e.*, rules of international law that are universally binding even the absence of consent.[11] It was not long before these two Twentieth Century innovations converged, with the field of *jus cogens* coming to be dominated by the emerging new human rights norms.[12]

The mechanisms for the enforcement of international law outside of the U.S. legal system are beyond the scope of this paper.[13] The focus here, rather, is on what Professor Koh has called "legal internalization," *i.e.*, the process by which "international norm[s] [are] incorporated into the domestic legal system through executive action, legislative action, judicial interpretation, or some combination of the three."[14] In recent years, all three branches of the federal government have claimed the power to incorporate interna-

tional human rights norms into domestic U.S. law and thereby to make the violation of such norms a violation of federal law. The remainder of this Part examines the means by which they have done so.

A. Internalization of International Human Rights Norms by the Courts

The story of the federal judiciary's incorporation of international human rights norms into domestic federal law begins with the Second Circuit's interpretation of the Alien Tort Statute (the "ATS") in the landmark case of *Filartiga v. Pena-Irala*.[15]

The ATS, enacted as part of the Judiciary Act of 1789, provides that "[t]he district courts shall have original jurisdiction of any civil action by an alien for a tort only, committed in violation of the law of nations or a treaty of the United States."[16] Essentially moribund for nearly two hundred years,[17] the ATS was invoked as the basis for statutory subject-matter jurisdiction in *Filartiga* by citizens of Paraguay who filed suit in federal court in New York against a Paraguayan police official for his alleged torture of their relative. The case reached the Second Circuit following the district court's dismissal for lack of jurisdiction.

With respect to statutory jurisdiction, the Second Circuit held that the ATS's threshold of a "tort . . . in violation of the law of nations" was met where the plaintiffs alleged the violation of any "established norms of the international law of human rights."[18] Whether the ATS's grant of federal court jurisdiction over such a lawsuit was constitutional presented a more difficult question. An act of Congress may not, of course, expand the jurisdiction of the federal courts beyond that set forth in Article III of the Constitution.[19] And because all parties to the suit were aliens, there was no Article III diversity jurisdiction.[20] Nor was there a readily apparent basis for federal-question jurisdiction because, as the Second Circuit recognized,[21] the ATS is a jurisdictional statute that does not itself create any rights under federal law.[22]

The Second Circuit nevertheless concluded that the plaintiffs' claims did arise under the laws of the United States. In doing so, the court relied on a series of nineteenth-century pronouncements by the Supreme Court that international law is "part of the law of the land"[23] and "part of our law."[24] The import of these statements, the court explained, is that the same established norms of international law that satisfied the jurisdictional threshold of the ATS are a part of "the common law of the United States," and that claims for their violation therefore "aris[e] under . . . the Laws of the United States" within the meaning of Article III.[25] Accordingly, the plaintiffs were permitted to pursue their claims.

Nearly every court to confront the matter since has followed *Filartiga* in sustaining jurisdiction over similar suits.[26] These lawsuits follow a typical pattern: an alien victimized by a repressive government in his country of origin files suit in the United States against foreign officers and private citizens said to have participated in any number of human rights abuses.[27] With the number of such suits burgeoning in recent years, the United States is rapidly becoming a forum for the adjudication of human rights grievances from around the world,[28] with its courts actively engaged in development of a federal common law of international human rights.[29]

B. Internalization of International Human Rights Norms by Congress

In enacting the ATS as a jurisdictional statute, Congress did not exercise any of its Article I foreign affairs powers.[30] Most observers believe, however, that Congress may act to internalize international human rights norms through its infrequently used power "[t]o define and punish Piracies and Felonies committed on the high Seas, and Offences against the Law of Nations."[31] Indeed, in ostensible reliance on that power, Congress acted partially to codify the result of *Filartiga* through the passage of the Torture Victim Protection Act of 1991 (the "TVPA").[32]

The TVPA creates a statutory cause of action for certain specified violations of international human rights law. Section 2 provides:

> "An individual who, under actual or apparent authority, or color of law, of any foreign nation—(1) subjects an individual to torture shall, in a civil action, be liable for damages to that individual; or (2) subjects an individual to extrajudicial killing shall, in a civil action, be liable for damages to the individual's legal representative, or to any person who may be a claimant in an action for wrongful death."[33]

The TVPA is more modest in several respects than the federal common law developed under *Filartiga*. First, as the quoted language demonstrates, only two categories of human rights abuses—torture and extrajudicial killing—are actionable. Second, the TVPA by its terms is limited to the official acts of persons acting under color of law of a foreign nation, whereas the common law of *Filartiga* has developed to prohibit certain acts by private individuals.[34] Third, the TVPA does not apply to corporations.[35] Fourth, the TVPA contains an express statute of limitations and a requirement that a plaintiff exhaust adequate and available local remedies before bringing suit in the United States.[36]

Despite these limitations, the TVPA has become an important weapon in the arsenal of plaintiffs seeking redress for human rights abuses.[37] The statute will likely serve as a model for future acts of Congress seeking to broaden the class of human rights abuses for which remedies are available under federal law.

C. Internalization of International Human Rights Norms by the President

A third method by which international human rights norms have been internalized in federal law is through the President's power (with the advice and consent of the Senate) to enter into international treaties.[38]

Like international law generally,[39] treaties historically regulated relations between nations, typically in the form of bilateral agreements.[40] But as with international law

generally, the gross human rights abuses of the Holocaust led to a modified conception of the scope and purpose of international agreements. The principal change has been the rise of multilateral human rights agreements that are open for ratification by any nation and designed to regulate the treatment of individuals by their own governments and countrymen.[41]

The United States generally declined to ratify these new multilateral agreements in the decades following the end of World War II.[42] Among the reasons were concerns that the treaties might be interpreted to impose obligations on the States beyond those set forth in the Constitution and permit Congress to implement such treaties with legislation that would, in the absence of the treaties, be beyond the scope of Congress's enumerated powers.[43] These concerns were significant enough that a proposed constitutional amendment to limit the scope of the treaty power gained significant support in the 1950s.[44]

Since the late 1980s, however, the United States has ratified four major human rights treaties: the Genocide Convention,[45] the International Covenant on Civil and Political Rights,[46] the Torture Convention,[47] and the International Convention on the Elimination of All Forms of Racial Discrimination.[48] As their names suggest, these agreements generally require their signatories to provide a significant range of human rights guarantees, such as freedom from genocide, torture and arbitrary arrest and detention, freedom of association and the right to self-determination.

The United States' increasing willingness to ratify human rights treaties is premised on the inclusion in the ratification instruments of a series of reservations, understandings and declarations (collectively known as "RUDs") limiting the treaties' domestic effects.[49] Generally, such RUDs include, *inter alia*, declarations stating that the treaties are not self-executing (so that they cannot be enforced domestically without implementing legislation by Congress) and federalism understandings that preclude any increase of congressional power.[50]

In light of the RUDs and Congress's failure to pass implementing legislation, courts have uniformly held that individuals lack standing to invoke these treaties.[51] Thus, while the various treaties are frequently raised in human rights litigation, they do not provide a basis for additional legal relief. They are, however, used by courts as evidence of the content of international law for purposes of establishing common-law causes of action. Moreover, the historical concerns over such treaties and the extensive use of RUDs to limit their effect demonstrate that they are also viewed by the government as potentially powerful tools for directly internalizing international human rights laws into domestic law.

III. The Federalism Implications of the Internalization of International Human Rights Norms

What does all this have to do with domestic federalism? While the focus of human rights litigation to date has been on abuses committed by and in foreign nations, all three methods of incorporating international human rights norms into federal law are premised on the existence of a federal power to enforce the modern conception of international law as a body of rules that govern relationships, not only between nations, but also between individuals and their governments and countrymen. And all three methods assume, either expressly or implicitly, that these modern international human rights norms, once incorporated into domestic law, bind domestic as well as foreign actors. In other words, to the extent international law *qua* U.S. law protects citizens of the Republic of Georgia from human rights abuses committed in Tbilisi, then it follows that such law also protects citizens of the State of Georgia from the same human rights abuses committed in Atlanta.

For now, the domestic application of international human rights law is largely theoretical. As noted above, the international human rights treaties entered into by the United States contain RUDs that, in effect, prevent them from having the force of law. The TVPA, Congress's only attempt to protect human rights under the Define and Punish Clause, by its terms extends *only* to wrongs perpetrated by persons acting under color of *foreign* law. And because the common law of *Filartiga* had its origins in ATS cases, which require alien plaintiffs, the potential for domestic application of that common law—which is just beginning to evolve beyond highly egregious conduct (such as genocide, slavery and torture) unlikely to occur in the United States—has only lately been realized. The few attempts to vindicate domestically rights said to arise under international human rights law have thus far been rejected by the courts.[52]

Nevertheless, it is easy to see the potential for a significant shift of power to the national government in this area. A future President might choose, with the Senate's approval, to enter into a broad human rights treaty without any RUDs making the treaty non-self-executing or preserving traditional limits on congressional power. A future Congress might pass another human rights statute based on the TVPA, this time omitting any exceptions for misconduct by public and private domestic actors. And it is only a matter of time before a federal court is receptive to a claim that certain domestic conduct violates a norm of international human rights law under *Filartiga*.

In these ways, the three branches' ostensible foreign affairs powers could be used to achieve domestic ends otherwise unattainable under the Supreme Court's Commerce and Enforcement Clause precedents. For example, Congress cannot use its Commerce and Enforcement Clause powers to regulate criminal punishments imposed by the States unless those punishments violate the Eighth Amendment.[53] Yet if a federal court, Congress or the President determines that the death penalty violates international human rights norms, then under the theories of internalization discussed above, any of them could prohibit the States from imposing that penalty by incorporating (via common law, statute or treaty) the relevant norms into federal law. In fact, several international law scholars have argued that applications of the death penalty violate international law and are therefore already illegal under federal common law.[54] Similarly, if local acts of gender-moti-

vated violence by private parties are deemed to violate international human rights law, then the courts, Congress and the President can regulate such acts through their foreign affairs powers, notwithstanding the Supreme Court's recent ruling that Congress lacks the power to regulate such acts under the Commerce and Enforcement Clauses.[55] Again, a number of commentators have urged this result.[56]

The national government's potential use of its foreign affairs powers to regulate local activity is particularly troublesome because of the nature of modern international law. Despite the sources of international law set forth in *Filartiga* and the Restatement, there is neither an authoritative arbiter of international law nor an objective method for determining the norms incorporated therein, making international human rights law necessarily indeterminate. Scholars and commentators have argued that international law protects, or may soon protect, rights relating to an incredibly broad range of topics, including (in addition to those discussed above) education, employment, property and sexual orientation.[57] International law "evolves," moreover, on the basis of the views of entities, such as domestic and foreign jurists, foreign and transnational courts and treatymaking bodies, that are "neither representative of the American political community nor responsive to it."[58] Under these circumstances, the potential for anti-democratic judicial activism in connection with the creation of a federal common law of international law cannot be overstated. Congress and the President, at least, will need a degree of popular support to use international law to aggrandize national power at the expense of the States, but that support is far less than would be needed to amend the Constitution to delegate such authority to the national government directly.

IV. Objections to the Internalization of International Human Rights Norms Into Domestic Federal Law

Any interpretation of the United States' foreign affairs powers resulting in such a profound shift of regulatory authority over local affairs from the States to the national government warrants closer examination. This Part examines a number of objections to the three methods of internalization described in Part II.

A. Federal Common Law

Of the three mechanisms used for internalization of international human rights norms into federal law, *Filartiga*'s holding that such norms are to be applied by courts as federal common law stands on the weakest footing. In taking out of context and relying on statements by the Supreme Court that international law is "part of our law" and "part of the law of the land,"[59] the Second Circuit made a crucial analytical mistake.[60] Each of those statements was made prior to the Supreme Court's seminal ruling in *Erie Railroad Co. v. Tompkins* that "[t]here is no federal general common law."[61] Before *Erie*, international law (like the law of torts and contracts) had been part of a federal general common law that, though not itself raising a federal question, provided the rules of decision for federal courts otherwise having jurisdiction over a case.[62] Pronouncements about the law of nations in the pre-*Erie* cases relied on by the Second Circuit in *Filartiga* involved such an application of general common law in cases over which the federal courts had an independent Article III jurisdictional basis (such as diversity or admiralty),[63] and simply had no bearing on the actual question presented in *Filartiga*, *i.e.*, whether "international law" arises under the laws of the United States within the meaning of Article III. In fact, the Second Circuit (and the other courts to consider the issue) simply missed or ignored numerous nineteenth- and early twentieth-century Supreme Court decisions that hold, unequivocally, that "international law" is not federal law.[64]

In contrast to the "federal general common law" repudiated in Erie, there is a modern, limited form of federal common law that has the status of federal law. Consistent with the post-Erie notion that federal courts are powerless to apply law not derived from a sovereign source, however, modern federal common law applies only where necessary to further "a genuinely identifiable (as opposed to judicially constructed) federal policy."[65] That there is no such policy favoring the wholesale creation of causes of action for violations of international human rights law is confirmed both by the political branches' cautious and incremental approaches to this field and by modern Supreme Court decisions.[66]

In short, the endeavor by the courts to create a federal common law of international human rights is completely misguided, and ought to be rejected.

B. The Define and Punish Clause

Unlike the federal courts' creation of a body of human rights common law, Congress's putative power to enact human rights legislation such as the TVPA is premised on a specific enumerated power. For this reason, even some of *Filartiga* harshest critics have concluded that, if *Filartiga* were overturned, "Congress . . . would still have the power to authorize the application of [customary international law]"—presumably including international human rights law—"as domestic federal law."[67] However, whether Congress's power to define and punish "Offences against the Law of Nations" extends to violations of modern international human rights law is a question that is not free from serious doubt.

Very little has been written on the meaning of the Define and Punish Clause, with the principal debate concerning whether congressional power thereunder is limited to the enactment of penal legislation.[68] That question, with its focus on the manner by which Congress may regulate, is beyond the scope of this paper. The concern here is with the proper *objects* of regulation under the Clause, and the answer to that question requires an understanding of the original meaning of the phrase "Law of Nations."

As noted in Part II, unlike the modern conception of international law, which extends to the relationships between private individuals and their own governments and countrymen, the law of nations at the time of the Founding was concerned with interstate relations. Emmerich de Vattel, a natural law theorist with significant influence on the Found-

ing generation, stated, "[t]he Law of Nations is the science which teaches the rights subsisting between nations or states and the obligations correspondent to those rights."[69] James Kent, echoing this theme in the early part of the nineteenth century, defined the law of nations as "that code of public instruction which defines the rights and prescribes the duties of nations in their intercourse with each other."[70]

Thus, the law of nations was the means "by which alone all controversies between nation and nation can be determined."[71] This is not to say that individuals did not have rights and obligations under international law. Eighteenth-century courts applied the law of nations (as general common law[72]) to matters where the conduct of private citizens touched upon relations between nations, such as where one nation's citizens injured or affronted the dignity of another nation or its officers or citizens.[73] Blackstone provided examples of such matters, noting that "[t]he principal offence against the law of nations . . . are of three kinds; 1. Violation of safe-conducts; 2. Infringement of the rights of embassadors; and, 3. Piracy."[74] Another area in which the law of nations regulated the conduct of private individuals was the field of prize, whereby warring nations (and their citizens) captured enemy merchant vessels.[75] Significantly, however, because the rights of individuals were necessarily tied to relations between nations, violations of the law of nations could not occur when the aggrieved parties were nationals of the acting state.

The United States' treatment of these issues prior to and just after the adoption of the Constitution is consistent with this understanding of the law of nations. In 1781, for example, the Continental Congress, itself lacking the necessary regulatory authority, passed a resolution recommending that the States punish "infractions of the laws of nations."[76] The resolution singled out, as the "most obvious" subjects of such legislation, violations of safe-conducts and passports granted by Congress to foreign subjects in times of war, acts of hostility against those in amity with the United States, infractions of the immunities of ambassadors and other public ministers, and treaty violations, recommending as well that the States create civil remedies for "injur[ies] done to a foreign power by a citizen."[77] A decade later, the newly empowered First Congress relied on the Define and Punish Clause to criminalize violations of safe-conducts and passports and affronts to and assaults on ambassadors and other public ministers.[78]

It seems clear, therefore, that congressional power under the Define and Punish Clause was understood to extend only to the regulation of conduct bearing on controversies between nations. Proponents of a congressional power to protect human rights under the Define and Punish Clause respond to this historical record by arguing that the term "Law of Nations" is flexible enough to include whatever the international community views as international law at a given period of time.[79] But while it may well be true that the content of the rules governing the relations between states can change over time, it is something entirely different to say that legislation need no longer be directed at such relations, but rather may extend to any object so long as that object is designated "international law" by Congress or the international community. The latter theory is not only at odds with appropriate interpretive methodologies,[80] but would also unmoor the Define and Punish Clause from its limited purpose of allowing the national government to speak with one voice in the area of foreign relations.

Under an interpretation of the Define and Punish Clause faithful to its original meaning, therefore, Congress lacks the power to define as violations of the law of nations wrongs committed against individuals by their own governments or countrymen, or to provide remedies for those wrongs.

C. The Treaty Power

On its face, the federal treaty power presents the best case for a national power to internalize international human rights law. The President is typically given considerable deference in his conduct of the nation's foreign affairs.[81] And unlike Congress's power under the Define and Punish Clause, the President's power under the Treaty Clause is not subject to an express subject-matter limitation, presumably permitting treaties to be made on any subject. Moreover, the Supreme Court has held that Congress's power to enforce a treaty (under the Necessary and Proper Clause[82]) is bounded only by the terms of the treaty, and not by the terms of Congress's other enumerated powers.[83]

However, there is reason to believe that the treaty power is not so unbounded. Recent scholarship has mustered convincing evidence from the Founding era that the Framers foresaw the arguments for an expansive use of the treaty power, and rejected them, instead understanding the word "treaties" to be a term of art referring to agreements concerning external matters relating to the United States' intercourse with foreign nations, such as war, peace, alliances, neutrality and commerce.[84] For example, in response to Anti-Federalist objections to the apparent breadth of the treaty power, James Madison explained that "[t]he object of treaties is the regulation of intercourse with foreign nations, and is external."[85] Thomas Jefferson similarly wrote (after ratification) that treaties "must concern the foreign nation party to the contract" and must "comprehend only those subjects which are usually regulated by treaty."[86] On this understanding of the treaty power, the treatment of individuals by their own governments and countrymen is no more a proper subject of a United States treaty than it is a proper subject of Define and Punish Clause legislation.

A second plausible limitation on the treaty power relates to the method by which treaty provisions become binding as U.S. law. Based primarily on the reference to treaties in the Supremacy Clause,[87] conventional wisdom holds that the President and Senate may choose to make a treaty self-executing, such that its terms are enforceable domestically without any further congressional implementing legislation.[88] Examining the Founding-era evidence, Professor Yoo has challenged this conventional wisdom, making a per-

suasive case that the Framers understood the treaty power to require action by Congress to implement those aspects of treaties "that ordinarily would fall within the scope of Congress's authority over legislation."[89] In addition to its historical support, such a theory makes sense in light of the contractual nature of a treaty.[90] A contract between nations may create international obligations, subject to traditional transnational enforcement mechanisms,[91] but that is all it does on its own; further steps to carry out those obligations must be taken by the constitutionally appropriate actors.[92]

On this theory, treaty provisions regulating the conduct of domestic actors cannot become effective without congressional legislation. But must such legislation fall within Congress's enumerated powers, or may Congress regulate any matter covered by a treaty? Notably, Article I does not expressly confer on Congress the power to carry treaty terms into effect. Rather, the congressional power to implement treaty terms is thought to come from the Necessary and Proper Clause.[93] The words of the Necessary and Proper Clause do not necessarily compel that conclusion, however, because the Clause gives Congress the power to enact laws for carrying into execution, not the *terms* of treaties, but the President's power "to *make* Treaties."[94] If, as noted above, there are significant constitutional differences between the making of a treaty and the execution of its terms, Congress may indeed be required to invoke one of its enumerated powers in order to execute a treaty. Whatever the merits of this argument as a textual matter, however, its acceptance would create a potentially large gap in the government's ability to meet the nation's treaty obligations (even with respect to traditional treaty subjects), and would require a sharp break from historical practice and settled Supreme Court precedent.[95]

Treaties present the most difficult questions concerning internalization of international human rights law. Contrary to the situations presented by judicial and congressional internalization, one cannot assert with confidence that the President lacks the power to internalize human rights norms via the treaty power. Yet a careful examination of the historical record and the Constitution's text and structure reveals that the existence of this power should not be taken for granted.

V. Conclusion

In recent years, the various branches of the federal government have sought to extend their regulatory authority to govern the treatment of foreign citizens by their own governments and countrymen. In doing so, they have created questionable legal precedents that foretell a broad increase in the national government's domestic powers, an increase that threatens to compel the "conclu[sion] that the Constitution's enumeration of powers does not presuppose something not enumerated, and that there never will be a distinction between what is truly national and what is truly local."[96] That this result could stem from the national government's foreign affairs powers demonstrates the fallacy of the view that international law is an esoteric field, the study of which may be left exclusively to the community of international law scholars and practitioners. To the lawyer concerned with domestic federalism, international law has never been more relevant.

* Chris Vergonis is an associate at Cravath, Swaine & Moore in New York. The views expressed in this paper are his own.

Footnotes

[1] The Supreme Court began its federalism revival in *Gregory v. Ashcroft*, 501 U.S. 452 (1991), and has decided at least one significant federalism case in nearly every Term since. The Court's decisions have placed limits on the scope of Congress's enumerated powers, *see, e.g.*, *United States v. Lopez*, 514 U.S. 549 (1995) (Commerce Clause); *City of Boerne v. Flores*, 519 U.S. 1088 (1997) (Enforcement Clause of the Fourteenth Amendment), and restricted the means by which Congress can apply laws within its enumerated powers to the States, *see, e.g.*, *Seminole Tribe of Florida v. Florida*, 517 U.S. 44 (1996); *Printz v. United States*, 521 U.S. 898 (1997).

[2] U.S. Const. art. I, § 8, cl. 3. The Supreme Court famously countenanced a broad interpretation of Congress's power to regulate commerce among the several States in the period between the New Deal and the Court's decision in *Lopez*. *See, e.g.*, *Perez v. United States*, 402 U.S. 146 (1971); *Katzenbach v. McClung*, 379 U.S. 294 (1964); *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964); *Wickard v. Filburn*, 317 U.S. 111 (1942).

[3] U.S. Const. amend. XIV, § 5. In a series of cases under the Voting Rights Act, the Court endorsed an expansive interpretation of Congress's power to enforce the Fourteenth Amendment, with the broadest statement of that power appearing in *Katzenbach v. Morgan*, 384 U.S. 641 (1966).

[4] The Civil Rights Act of 1964 was enacted and upheld as an exercise of the Commerce Clause power, *see Katzenbach v. McClung*, 379 U.S. 294 (1964), even though similar legislation had been invalidated when defended as an exercise of the Enforcement Clause power, *see The Civil Rights Cases*, 109 U.S. 3 (1883).

[5] The Supreme Court decided just one case interpreting the substantive scope of the Enforcement Clause power between 1971 and 1996, *see City of Rome v. United States*, 446 U.S. 152 (1980), but has since decided six such cases, *see Board of Trustees of the Univ. of Alabama v. Garrett*, 531 U.S. 356 (2001); *Kimel v. Florida Board of Regents*, 528 U.S. 62 (2000); *United States v. Morrison*, 120 S. Ct. 1740 (2000); *Florida Prepaid Postsecondary Education Expense Board v. College Savings Bank*, 527 U.S. 627 (1999); *College Savings Bank v. Florida Prepaid Postsecondary Education Expense Board*, 527 U.S. 666 (1999); *City of Boerne*, 519 U.S. 1088, and granted *certiorari* in a seventh, *see Nevada Dep't of Human Resources v. Hibbs*, 122 S. Ct. 2618 (2002) (mem.).

[6] In doing so, it does not lay claim to complete originality. As discussed below, elements of the expansive view of the foreign affairs power have been searchingly criticized by others. *See, e.g.*, *infra* notes 60 & 84 and accompanying text. This paper also takes no position on the desirability of these legal developments from a foreign policy perspective, another matter that has received a significant amount of attention in certain quarters. *See, e.g.*, Curtis A. Bradley, *The Costs of International Human Rights Litigation*, 2 Chi. J. Int'l L. 457 (2001); Sonni Efron, *U.S. Wants Suit by Indonesians Dismissed*, L.A. Times, Aug. 7, 2002, at A7 (discussing State Department argument that permitting villagers to seek damages in federal court for human rights abuses in Indonesia would harm U.S. foreign policy interests).

[7] Restatement (Third) Foreign Relations Law of the United States pt. I, ch. 1, intro. note, at 16 (1987) [hereinafter Restatement].

[8] *Id.* § 102(2). "General principles common to the major legal systems" of the world also "may be invoked as supplementary rules of international law where appropriate." *Id.* § 102(4).

[9] *Id.* § 701, cmt. a.

[10] *See id.* § 702. The extent to which international law condemns such conduct when committed by non-governmental actors is disputed, but there is a definite trend towards the view that it does. *See, e.g.*, *Kadic*

v. Karadzic, 70 F.3d 232, 239 (2d Cir. 1995) ("[C]ertain forms of conduct violate the law of nations whether undertaken by those acting under the auspices of a state or only as private individuals."); *Iwanowa v. Ford Motor Co.*, 67 F. Supp. 2d 424, 445 (D.N.J. 1999) ("No logical reason exists for allowing private individuals and corporations to escape liability for universally condemned violations of international law merely because they were not acting under color of law."); Jordan J. Paust, *Human Rights Responsibilities of Private Corporations*, 35 VAND. J. TRANSNAT'L L. 801, 801-17 (2002).

[11] *See* Alfred P. Rubin, *Actio Popularis, Jus Cogens and Offenses Erga Omnes?*, 35 NEW ENG. L. REV. 265 (2001).

[12] *See* Karen Parker & Lyn B. Neylon, *Jus Cogens: Compelling the Law of Human Rights*, 12 HASTINGS INT'L & COMP. L. REV. 411, 427-43 (1989).

[13] International law is often enforced in transnational courts established by agreements between nations. For example, the International Court of Justice, the principal judicial organ of the United Nations, hears disputes between nations that have accepted its jurisdiction. See International Court of Justice General Information - The Court at a Glance (June 7, 2002) (available at http://www.icj-cij.org/icjwww/igeneralinformation/icjgnnot.html). Similarly, the International Criminal Court has been established to try incidents of genocide, crimes against humanity, war crimes and aggression committed by, or within the jurisdiction of, signatory nations. *See* Rome Statute of the International Criminal Court, *opened for signature* July 17, 1998, art. 126, 37 I.L.M. 999. For an examination of transnational enforcement issues, see Harold H. Koh, *How Is International Human Rights Law Enforced?*, 74 IND. L.J. 1397 (1998).

[14] Koh, *supra* note 13, at 1414.

[15] 630 F.2d 876 (2d Cir. 1980).

[16] 28 U.S.C. § 1350. The original language provided that the federal district courts "shall also have cognizance . . . of all causes where an alien sues for a tort only in violation of the law of nations or a treaty of the United States." Judiciary Act of 1789, ch. 20, § 9(b), 1 Stat. 73, 77.

[17] *See Tel-Oren v. Libyan Arab Republic*, 726 F.2d 774, 812-13 & n.21 (D.C. Cir. 1984) (Bork, J., concurring).

[18] *Filartiga*, 630 F.2d at 880. For a discussion of the sources used to determine whether a human rights norm is established, see *infra* note 29.

[19] *See Verlinden B.V. v. Central Bank of Nigeria*, 461 U.S. 480, 491 (1983).

[20] *See Hodgson v. Bowerbank*, 9 U.S. (5 Cranch) 303, 303 (1809). Nor did *Filartiga* belong to the category of "cases affecting ambassadors, other public ministers and consuls," U.S. CONST. art. III, § 2, which were among the principal suits contemplated by the ATS, *see Tel-Oren*, 726 F.2d at 813-14 (Bork, J., concurring).

[21] *Filartiga*, 630 F.2d at 887.

[22] *See Mesa v. California*, 489 U.S. 121, 136 (1989) (explaining that a "pure jurisdictional statute" is not an independent source of Article III "arising under" jurisdiction). That the ATS is a pure jurisdictional statute is clear from its placement in the Judiciary Act and from the plain meaning of both the original language and the current text. *See* Curtis A. Bradley, *The Alien Tort Statute and Article III*, 42 VA. J. INT'L L. 587, 592-97 (2002) (rejecting the theory that the ATS is anything but jurisdictional). Nor is there any indication that Congress intended to delegate to the courts the power to create common law rules as in *Textile Workers Union v. Lincoln Mills*, 353 U.S. 448 (1957). *See Filartiga*, 630 F.2d at 887 (rejecting application of *Lincoln Mills* to the ATS). Accordingly, it is a mistake to view the ATS, as some courts and commentators have, *see, e.g.*, *Hilao v. Estate of Marcos*, 25 F.3d 1467, 1474-75 (9th Cir. 1994), as an exercise of Congress's Article I power to define and punish offenses against the law of nations. *Cf. The Propeller Genesee Chief*, 53 U.S. (12 How.) 443, 451-52 (1851) (holding that "it would be inconsistent with the plain and ordinary meaning of words, to call a law defining the jurisdiction of certain courts of the United States" an exercise of Congress's commerce powers).

[23] *The Nereide*, 13 U.S. (9 Cranch) 388, 422 (1815), *quoted in Filartiga*, 630 F.2d at 887.

[24] *The Paquete Habana*, 175 U.S. 677, 700 (1900), *quoted in Filartiga*, 630 F.2d at 887.

[25] *Filartiga*, 630 F.2d at 885-87. The Second Circuit's conclusion that international law is federal common law immediately made the ATS's jurisdictional grant (and its alien plaintiff limitation) superfluous, however, because causes of action arising under federal common law can be brought (by aliens and U.S. citizens alike) pursuant to the federal-question jurisdictional statute, 28 U.S.C. § 1331.

[26] *See, e.g.*, *Beanal v. Freeport-McMoran, Inc.*, 197 F.3d 161, 164-65 (5th Cir. 1999); *Abebe-Jira v. Negewo*, 72 F.3d 844, 847-48 (11th Cir. 1996). The exception is the D.C. Circuit, which held (without a majority rationale) that *Filartiga*-style claims are not justiciable in federal court. *See Tel-Oren*, 726 F.2d at 775 (per curiam).

[27] In recent years, for example, such lawsuits have been filed against individuals and corporations for their alleged complicity in war crimes in Bosnia, *see Kadic v. Karadzic*, 70 F.3d 232 (2d Cir. 1995); anti-union violence in Colombia, *see Sinaltrainal v. Coca-Cola Co.*, No. 01-03208-CIV (S.D.N.Y. filed July 21, 2001); environmental degradation in Papua New Guinea, *see Tamuasi v. Rio Tinto, plc*, No. 00-CV-3208 (N.D. Cal. filed Sept. 6, 2000); human rights abuses in Nigeria, *see Wiwa v. Royal Dutch Petroleum Co.*, 226 F.3d 88 (2d Cir. 2000); and slavery in Burma, *see Doe v. Unocal Corp.*, 110 F. Supp. 2d 1294 (C.D. Cal. 2000).

[28] *See* Elizabeth Amon, *Coming to America: Alien Tort Claims Act Provides a Forum For the World*, NAT'L L.J, Oct. 19, 2000, at 1.

[29] In adjudicating these lawsuits, courts generally follow *Filartiga*'s directive to determine the current content of an "evolving" international law by looking to the works of domestic and foreign jurists, the practices of nations, international conventions, treaties and agreements, and judicial decisions from around the world. *See Filartiga*, 630 F.3d at 880-81; RESTATEMENT, *supra* note 7, at § 103.

[30] *See supra* note 22.

[31] U.S. CONST., art. I, § 8, cl. 10. The few congressional statutes to have rested on the Define and Punish Clause include prohibitions on interference with the diplomatic rights of ambassadors, *see* An Act for the Punishment of certain Crimes against the United States, ch. IX, §§ 25-28, 1 Stat. 112, 117-18, the counterfeiting of a foreign government's securities, *see United States v. Arjona*, 120 U.S. 479 487, 488 (1887), and war crimes during wartime, *see Ex Parte Quirin*, 317 U.S. 1, 27 (1942).

[32] Pub. L. No. 102-256, 106 Stat. 73 (1992), *reprinted in* 28 U.S.C. § 1350 (1994). The House Report states that Congress acted to "establish an unambiguous and modern basis for a cause of action that has been successfully maintained under [the ATS]." H.R. Rep. No. 102-367, at 3 (1992). The Senate Report makes clear that Congress believed that its power to enact the TVPA was derived from the Define and Punish Clause. *See* S. Rep. No. 102-249, at 5-6 (1992).

[33] TVPA § 2(a).

[34] *See supra* note 10.

[35] *See Beanal v. Freeport-McMoRan, Inc.*, 969 F. Supp. 362, 382 (E.D. La. 1997), *aff'd on other grounds*, 197 F.3d 161 (5th Cir. 1999).

[36] TVPA § 2(b)-(c).

[37] A statutory cause of action under the TVPA is often asserted in human rights litigation in conjunction with *Filartiga*-style common law claims. *See, e.g.*, *Hilao v. Estate of Marcos*, 103 F.3d 767, 778-79 (9th Cir. 1996); *Mehinovic v. Vuckovic*, 198 F. Supp. 2d 1322, 1347 (N.D. Ga. 2002).

[38] U.S. CONST. art. II, § 2, cl. 2.

[39] *See supra* notes 8-12 and accompanying text.

[40] *See* Curtis A. Bradley & Jack L. Goldsmith, *Treaties, Human Rights, and Conditional Consent*, 149 U. PENN. L. REV. 399, 400 (2000).

[41] *See id.* at 400, 410-15.

[42] *See id.* at 410-13.

[43] *See, e.g.*, *Missouri v. Holland*, 252 U.S. 416, 432 (1920) ("If the treaty is valid there can be no dispute about the validity of the statute [implementing the treaty] under Article 1, Section 8, as a necessary and proper means to execute the powers of the Government.").

[44] *See* DUANE TANANBAUM, THE BRICKER AMENDMENT CONTROVERSY: A TEST OF EISENHOWER'S POLITICAL LEADERSHIP (1988).

[45] The Convention on the Prevention and Punishment of the Crime of Genocide, *opened for signature* Dec. 9, 1948, 78 U.N.T.S. 277.

[46] The International Covenant on Civil and Political Rights, *opened for signature* Dec. 19, 1966, 999 U.N.T.S. 171.

[47] The Convention Against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment, *opened for signature* Dec. 10, 1984, 23 I.L.M. 1027.

[48] The International Convention on the Elimination of All Forms of Racial Discrimination, *opened for signature* Mar. 7, 1966, 660 U.N.T.S. 195.

[49] *See* Bradley & Goldsmith, *supra* note 40, at 400-01, 413-22.

[50] *Id.* at 416-22. Professors Bradley and Goldsmith persuasively refute the arguments of some scholars that treaty RUDs violate international law rules of treaty formation and the U.S. Constitution. *See id.* at 422-54; *see also* John C. Yoo, *Globalism and the Constitution: Treaties, Non-Self-Execution and the Original Understanding*, 99 Colum. L. Rev. 1955 (1999) (demonstrating that treaty non-self-execution is consistent with the original understanding of the treaty power).

[51] *See, e.g.*, *Igartua de la Rosa v. United States*, 32 F.3d 8, 10 n.1 (1st Cir. 1994) (per curiam); *Akhtar v. Reno*, 123 F. Supp. 2d. 191, 196-97 (S.D.N.Y. 2000).

[52] *See, e.g.*, *Buell v. Mitchell*, 274 F.3d 337, 370-76 (6th Cir. 2001); *White v. Paulsen*, 997 F. Supp. 1380, 1383-85 (E.D. Wash. 1998).

[53] Such regulations would have an insufficient connection to interstate commerce, and Congress lacks the power to expand the substantive scope of the rights protected by the Eighth Amendment. *See City of Boerne*, 519 U.S. at 527-28.

[54] *See, e.g.*, Julian S. Nicholls, Comment, *Too Young to Die: International Law and the Imposition of the Juvenile Death Penalty in the United States*, 5 Emory Int'l L. Rev. 617, 651-52 (1991) (arguing that the juvenile death penalty violates federal common law); *cf.* Christian A. Levesque, Comment, *The International Covenant on Civil and Political Rights: A Primer for Raising a Defense Against the Juvenile Death Penalty in Federal Courts*, 50 Am. Univ. L. Rev. 755, 790-91 (2001) (arguing that the ICCPR prohibits the juvenile death penalty); Beth Stephens, *Federalism and Foreign Affairs: Congress's Power to "Define and Punish . . . Offenses Against the Law of Nations,"* 42 Wm. & Mary L. Rev. 447, 552 (2000) (arguing that congressional legislation banning States from carrying out the juvenile death penalty is "exactly the situation contemplated by the [Define and Punish] Clause").

[55] *United States v. Morrison*, 120 S. Ct. 1740 (2000) (invalidating Violence Against Women Act).

[56] *See, e.g.*, Mary Ann Case, *Reflections on Constitutionalizing Women's Equality*, 90 Calif. L. Rev. 765, 774 n.56 (2002); Jordan J. Paust, *Human Rights Purposes of the Violence Against Women Act and International Law's Enhancement of Congressional Power*, 22 Hous. J. Int'l L. 209 (2000).

[57] *See* Curtis A. Bradley & Jack L. Goldsmith, *Customary International Law as Federal Common Law: A Critique of the Modern Position*, 110 Harv. L. Rev. 815, 841 & nn. 170-71 (1997) (providing examples of such arguments).

[58] Phillip R. Trimble, *A Revisionist View of Customary International Law*, 33 U.C.L.A. L. Rev. 665, 721 (1986).

[59] *See supra* notes 23-24 and accompanying text.

[60] *Filartiga*'s conceptual misstep has been criticized in depth. *See* Bradley & Goldsmith, *supra* note 57, at 849-70; Curtis A. Bradley & Jack L. Goldsmith, *Federal Courts and the Incorporation of International Law*, 111 Harv. L. Rev. 2260, 2263-65 (1998); Arthur M. Weisburd, *The Executive Branch and International Law*, 41 Vand. L. Rev. 1205, 1239-50 (1988).

[61] 304 U.S. 64, 78 (1938).

[62] *See Huntington v. Attrill*, 146 U.S. 657, 683 (1892) (explaining that if a "question of international law" arises in federal court, "it is one of those questions of general jurisprudence which that court must decide for itself," but if it is decided in State court, "the Constitution and laws of the United States have not authorized" Supreme Court review).

[63] For example, *The Paquete Habana* and *The Nereide*, *see supra* notes 23-24, were admiralty cases.

[64] *See, e.g.*, *N.Y. Life Ins. Co. v. Hendren*, 92 U.S. 286, 286-87 (1875) (holding that "the law of nations" does not present "any Federal question"); *Oliver Am. Trading Co. v. Mexico*, 264 U.S. 440, 442-43 (1924); *Huntington*, 146 U.S. at 683; *Ker v. Illinois*, 119 U.S. 436, 444 (1886); *cf.* 5 Op. Att'y Gen. 691, 692 (1802) ("doubt[ing] the competency of the federal courts" to hear "an aggravated violation of the law of nations" in the absence of a congressional "statute recognizing the offence"). Indeed, the Second Circuit in *Filartiga* essentially adopted the reasoning of Justice Bradley, the sole *dissenting* Justice in *New York Life*. *See* 92 U.S. at 287-88 (Bradley, J., dissenting) (arguing that "unwritten international law" is part of the "laws of the United States").

[65] *O'Melveny & Meyers v. F.D.I.C.*, 512 U.S. 79, 89 (1994); *cf. D'Oench, Duhme & Co. v. F.D.I.C.*, 315 U.S. 447, 472 (1942) (Jackson, J., concurring) (observing that "[f]ederal common law implements the federal Constitution and statutes, and is conditioned by them").

[66] For example, in *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964), the Supreme Court held that the act of state doctrine (which prevents certain foreign official acts from being challenged in U.S. courts) has the status of modern federal common law. But the Court made clear that the doctrine, with its "'constitutional' underpinnings," originated not in international law but in constitutional separation of powers principles. *Id.* at 422-24. In fact, in holding that the act of state doctrine applied even where the foreign act violated international law, *Sabbatino* "declared the ascertainment and application of international law beyond the competence of the courts of the United States," *id.* at 439 (White, J., dissenting), and "did not consider international law to be part of the law of the United States in the sense that United States courts must find and apply it as they would have to do if international legal rules had the same status as other forms of United States law," Harold G. Maier, *The Authoritative Sources of Customary International Law in the United States*, 10 Mich. J. Int'l L. 450, 463 (1989).

[67] Bradley & Goldsmith, *supra* note 57, at 871.

[68] *Compare* Stephens, *supra* note 54, at 508-19 (arguing that Congress is empowered under the Clause to enact civil legislation) *with* Charles D. Siegal, *Deference and Its Dangers: Congress' Power to "Define . . . Offenses Against the Law of Nations,"* 21 Vand. J. Transnat'l L. 865, 866-67 (1988) (arguing that the Clause permits only penal legislation). That Congress's power under the Clause extends only to penal legislation was the view of the Department of Justice when Congress debated passage of the TVPA. *See* Hearing on S. 1629 and H.R. 1662 Before the Subcomm. on Immigration and Refugee Affairs of the Senate Comm. on the Judiciary, 101st Cong., 2d Sess. 12, 13 (1990) (prepared statement of John O. McGinnis, Deputy Assistant Attorney General, Office of Legal Counsel, U.S. Department of Justice).

[69] Emmerich de Vattel, The Law of Nations § 3 (Joseph Chitty ed. & trans., Phila., T. & J.W. Johnson & Co. new ed. 1852) (1758). For Vattel's influence on American thought, see Douglas J. Sylvester, *International Law As Sword or Shield? Early American Foreign Policy and the Law of Nations*, 32 N.Y.U. J. Int'l L. & Pol. 1, 67 (1999).

[70] 1 James Kent, Commentaries on American Law 1 (New York, O. Halsted 1826). It is sometimes said that the law of nations also referred to commercial fields like maritime law and the law merchant, *see, e.g.*, Bradley, *supra* note 22, at 599, but these areas are not what the Framers had in mind when using the term "law of nations." As Vattel explained, "[t]he Romans often confounded the law of nations with the law of nature, giving the name of 'the law of nations' (*Jus Gentium*) to the law of nature [which included universal rules governing commercial transactions]." Vattel, *supra* note 69, at vii-viii. By contrast, eighteenth-century commentators were "generally agreed in restricting the appellation of 'the law of nations' to that system of right and justice which ought to prevail between nations and sovereign states", *i.e.*, to what the Romans called "right of embassies" and "*fecial* law." *Id.* at viii.

[71] Justice James Iredell, Charge to the Grand Jury for the District of South Carolina (May 12, 1794), *reprinted in* Gazette of the United States (Philadelphia), June 12, 1794, *quoted in* Sylvester, *supra* note 69, at 58.

[72] *See supra* notes 59-64 and accompanying text.

[73] *See Tel-Oren*, 726 F.2d at 813-14 (Bork, J., concurring); Anne-Marie Burley, *The Alien Tort Statute and the Judiciary Act of 1789: A Badge of Honor*, 83 Am. J. Int'l L. 461, 475-80 (1989); John M. Rogers, *The Alien Tort Statute and How Individuals 'Violate' International Law*, 21 Vand. J. Transnat'l L. 47, 49-50 (1988).

[74] 4 William Blackstone, Commentaries on the Laws of England 68, 72.

Professor Rogers has taken issue with the characterization of piracy as a violation of the law of nations, on the grounds that a wrong committed by private individuals outside a nation's jurisdiction "does not result in the violation of one state's obligations to another." Rogers, *supra* note 73, at 50. His theory is consistent with the Founding-era conception of the law of nations and explains why the Define and Punish Clause's grant to Congress of the power to define and punish *both* "Offences against the Law of Nations" *and* "Piracies" is not redundant.

[75] *See* Joseph M. Sweeney, *A Tort Only in Violation of the Law of Nations*, 18 HASTINGS INT'L & COMP. L. REV. 445, 451-67 (1995).

[76] 21 JOURNALS OF THE CONTINENTAL CONGRESS 1774—1789, at 1136 (Library of Congress 1912).

[77] *Id.* at 1136-37.

[78] *See* An Act for the Punishment of certain Crimes against the United States, ch. IX, §§ 25-28, 1 Stat. 112, 117-19 (1790).

[79] *See* Stephens, *supra* note 54, at 477-83.

[80] *See* Gary Lawson, *On Reading Recipes . . . And Constitutions*, 85 GEO. L. REV. 1823 (1997). The Seventh Amendment's guarantee of a jury trial "[i]n Suits at common law", U.S. CONST. amend. VII, provides a useful analogy. The Supreme Court has applied that right to causes of action not existing at the time the Amendment was adopted, but only if those causes of action are "analogous" to eighteenth-century common-law causes of action. *See Granfinanciera, S.A. v. Nordberg*, 492 U.S. 33, 42 (1989).

[81] *See, e.g.*, *Regan v. Wald*, 468 U.S. 222, 242 (1984).

[82] U.S. CONST. art. 1, § 8, cl. 18.

[83] *See supra* note 43 and accompanying text.

[84] *See* Curtis A. Bradley, *The Treaty Power and American Federalism*, 97 MICH. L. REV. 390, 411, 413-17 (1998).

[85] *Id.* at 413 (quoting *The Debates in The Convention of the Commonwealth of Virginia*, *reprinted in* 3 ELLIOT'S DEBATES 513 (Jonathan Elliot ed., 2d ed. 1888)).

[86] *Id.* at 415 (quoting Thomas Jefferson, *A Manual of Parliamentary Practice: For the Use of the Senate of the United States*, *in* JEFFERSON'S PARLIAMENTARY WRITINGS 420, 420 (Wilbur S. Howell ed., 1988)); *see also* THE FEDERALIST No. 75 (Alexander Hamilton), *reprinted in* 16 THE DOCUMENTARY HISTORY OF THE RATIFICATION OF THE CONSTITUTION 482 (John P. Kaminski & Gaspare J. Saladino eds., 1986).

[87] *See* U.S. CONST. art. VI, cl. 2.

[88] *See, e.g.*, Carlos M. Vazquez, *The Four Doctrines of Self-Executing Treaties*, 89 AM. J. INT'L L. 695, 706 (1995).

[89] Yoo, *supra* note 50, at 2094. *See also* John C. Yoo, *Treaties and Public Lawmaking: A Textual and Structural Defense of Non-Self-Execution*, 99 COLUM. L. REV. 2218 (1999). *But see Ware v. Hylton*, 3 U.S. (3 Dall.) 199, 244 (1796) (suggesting that treaty obligations are self-executing).

[90] As Alexander Hamilton explained, "the power of making treaties is neither" legislative nor executive in nature, but rather has as its objects "CONTRACTS with foreign nations", which are "not rules prescribed by the sovereign to the subject, but agreements between sovereign and sovereign." THE FEDERALIST No. 75 (Alexander Hamilton), *reprinted in* THE DOCUMENTARY HISTORY OF THE RATIFICATION OF THE CONSTITUTION, *supra* note 86, at 482.

[91] *See supra* note 13.

[92] Under this theory, where the treaty obligation is executive in nature, such as the withdrawal or placement of U.S. troops or the settlement of legal claims against a foreign nation, it can being carried out by the President without congressional legislation. But to achieve "domestic legislative effects," treaties need "congressional implementation." Yoo, *supra* note 50, at 2085 (paraphrasing James Madison's arguments during the House of Representatives debate about implementing legislation for the Jay Treaty).

[93] *See supra* notes 82-83 and accompanying text.

[94] U.S. CONST. art. II, §2, cl. 2 (emphasis added).

[95] The portion of the Supreme Court's holding in *Missouri v. Holland* relating to congressional authority, *see supra* note 43, was not novel. *See Neely v. Henkel*, 180 U.S. 109, 121 (1901) (holding that the Necessary and Proper Clause "includes the power to enact such legislation as is appropriate to give efficacy to any stipulations which it is competent for the President by and with the advice and consent of the Senate to insert in a treaty with foreign power"); *Prigg v. Pennsylvania*, 41 U.S. (16 Pet.) 539, 619 (1842) ("Treaties . . . often contain special provisions, which . . . require the interposition of congress to carry them into effect, and congress has constantly, in such cases, legislated on the subject; yet . . . the power is nowhere in positive terms conferred upon congress to make laws to carry the stipulations of treaties into effect; it has been supposed to result from the duty of the national government to fulfil all the obligations of treaties.").

[96] *Lopez*, 514 U.S. at 567-68 (internal citations omitted).

Intellectual Property

A Reemergence of Regulation at the Interface Between Patents and Antitrust?

*By F. Scott Kieff and Hon. Gerald J. Mossinghoff**

At the end of 2001, the Federal Trade Commission and the Antitrust Division of the Justice Department announced plans for joint hearings "to develop a better understanding of how to manage the issues that arise at the intersection of antitrust and intellectual property law and policy."[1] The resulting hearings spanned almost the entire year of 2002, covered a wide range of topics, but placed particular emphasis on perceived problems in the patent system.[2] Although the impact of these hearings in 2003 and beyond may not be determined for some time, it has potential to be quite substantial. In the least, the record of these hearings will be an important resource for policy makers and commentators, among others. Yet a look back over the hearings reveals some flaws in their basic premises about patent law and practice that could seriously undermine the hearings' central goal of improved understanding. Many of these flaws are reminiscent of earlier efforts to regulate patents at the beginning of the past century. Those earlier efforts lead to the Congressional actions to codify our present patent system in the 1952 Patent Act and statutorily reverse the entire bodies of case law the earlier efforts had generated.

Fundamental review of the patent system at the beginning of the last century was centered on President Roosevelt's efforts to study what he termed "concentrated economic power" and the resulting Temporary National Economic Committee.[3] These in turn led to a gradual but steady erosion of patent rights throughout the courts. In particular, patent validity determinations became dependent upon an entirely tautological standard: to be patentable, an invention had to constitute what a judge considered to be an "invention." This standard became so vague and yet so difficult to satisfy that Justice Jackson remarked "[T]he only patent that is valid is one which this court has not been able to get its hands on."[4] In addition, asserting antitrust concerns, the courts had all but eliminated the patent law doctrines of contributory infringement and inducement of infringement, which had the intended effect of invalidating patent licenses to those who would have been potentially liable as a contributory or inducing infringer. In response, Congress passed the 1952 Patent Act, which codified the doctrines of contributory and induced infringement in Section 271 of the Patent Act and set forth an objective test for patentability called "nonobviousness" in Section 103 of the Patent Act.

The 1952 Patent Act marked a monumental change for the patent system. Both of its major innovations – the revival of contributory and induced infringement in Section 271 and the replacement of the subjective requirement for invention with the objective requirement of nonobviousness in Section 103 – have major implications for the interface between patents and antitrust. More specifically, when antitrust regulators consider questions like "are patents too broad?" they run the risk of ignoring the statute's objective standards of patentability. Similarly, when antitrust regulators consider questions like "are patent licenses or refusals to license permissible?" they run the risk of ignoring the statute's express safe harbors, which set forth what does not constitute misuse.

The Supreme Court itself took quite some time to recognize the importance of these innovations of the 1952 Act. Over ten years passed after implementation of the 1952 Act before the Supreme Court, in the famous *Graham* case, instructed lower courts to apply the framework of the new Section 103 requirement of nonobviousness.[5] Almost thirty years passed after implementation of the 1952 Act before the Supreme Court, in the famous *Dawson* case, instructed lower courts to apply the framework of the new Section 271 provisions about what does not constitute misuse.[6] Today's regulatory review of the patent system should not lightly set aside these hard fought innovations in the patent system, especially without offering some reason other than those already considered and rejected by Congress and the Court.

Oddly, a common "new reason" offered as a justification for reconsidering the patent system is that the existing patent system with its roots in yesterday's legislative and judicial views is necessarily ill adapted to today's new technologies. According to critics, for example, what could the Framers, or even the drafters of the 1952 Act, have envisioned about the internet? But the charge that the law must change to accommodate the new subject matters for which some patents are being sought today makes little sense. Among the many legal regimes that might possibly face a charge of not being designed to deal with new technologies, the patent system must have the best defense precisely because it is a legal system expressly designed with such unforeseen technologies in mind. Indeed, technologies that are so foreseeable as to be obvious are not patentable even under the new objective standard of patentability in Section 103, and certainly would not be patentable under the subjective standard used before the 1952 Act.[7]

Not only is the patent system well adapted for new technologies in theory, it turns out to work well with new technologies in practice. For example, the charge that today too many invalid patents have too strong of an *in terrorem* effect on industries where patents are only recently

being used, such as the business methods on the internet, is belied by the recent decision by the Federal Circuit to reverse the grant of a preliminary injunction in the *BarnesandNoble.Com* suit over the patent on one-click shopping because of potential obviousness not adequately considered by the district court.[8]

More generally, questions about patent scope in theory can be better understood when viewed in the context of the complex interactions in practice in the patent system between the rules for enforcing and obtaining patents, which operate dynamically through the crux of the patent – the claim – to ensure that patents have a scope that is "just right."[9] As Judge Giles Rich often said about patents, "the name of the game is the claim . . . [and] the function of claims is to enable everyone to know, without going through a lawsuit, what infringes the patent and what does not."[10] According to Judge Rich, claims present a fundamental dilemma for every patentee because "the stronger a patent the weaker it is and the weaker a patent the stronger it is."[11] By this dilemma, he meant that a broad patent claim is strong on offense because it covers more and therefore is more likely to be infringed, but it also is weak on defense because it may cover something in the prior art or fail to contain a sufficiently detailed disclosure, and therefore is more likely to be invalid; while a narrow claim is weak on offense, because it covers less and therefore is less likely to be infringed, but it also is strong on defense because it is less likely to cover something in the prior art or fail to contain a sufficiently detailed disclosure, and therefore also is less likely to be invalid.[12] In the least, this means that no patent is "too broad" without at the same time being invalid. What is more, this means that the patent applicant has a large incentive to make his own correct determination of validity and scope before filing, and this incentive causes patentees themselves to make decisions that tend to keep their own patent scope "just right" from a social perspective.[13]

Similarly, questions about patent licensing and misuse in theory can be better understood when viewed in the context of the patent system's actual rules for licensing that were codified in the 1952 Patent Act and recognized by *Dawson*. These rules maximize the likelihood that all those wanting use of whatever is covered by the patent will get it. Putative licensees who place a high value on such use and those who place a low value on such use are both attractive targets to a patentee as long as the patentee is allowed to set a different price for different users. This practice is called price discrimination. Patent law allows patentees to price discriminate among such licensees because this gives patentees a strong financial incentive to ensure all those desiring use get use; even a monopolist who can price discriminate will push output to the full competitive output level.[14] Such beneficial price discrimination can take place because patent law, and contract law, allow for the enforcement of the restrictive licenses needed to prevent arbitrage between low value and high value users.[15] In the presence of such a system, a patentee is rationally motivated to avoid posting an excessive price because to do so would scare away would-be paying customers and this result would be a money-losing venture.

Even where the user is not able to pay any positive price, the patentee may be rationally motivated to grant a license for free. The granting of a free license may provide the patentee with an inexpensive way to preserve the legal force of the patent property right for use in other transactions with paying customers.[16] The patentee may also be able to derive advertising benefits from such uses as long as they are successful uses and their low price does not cause customer-relations harm with the high-paying customer base.[17] Thus, even very low value users are likely to be able to obtain licenses from the patentee.

Some argue that while patentees may be rationally motivated to sell permission to each user, and while users may be rationally motivated to buy permission from patentees, such sales may not be consummated because of various market failures.[18] In response to these concerns, some commentators argue that patents should be protected by a liability rule[19] instead of a property rule. One type of liability rule often suggested is some form of compulsory license, either directly by granting to the patentee's competitors a right to use whatever is covered by the patent or indirectly by denying the patentee the ability to enforce the express statutorily granted "right to exclude others" set forth in Section 154(a)(1) of the Patent Act.

Indeed, there are already important liability rule provisions in patent law today. Otherwise infringing uses that are by or for the federal government enjoy sovereign immunity protection that essentially results in a compulsory licensing regime.[20] In addition, the high costs of litigation under the present rules of civil procedure and the ability for an infringer to be kept effectively judgment proof through corporate and bankruptcy laws may also operate as a form of liability rule gloss on the present property rule regime.[21]

Moreover, the political process provides several solutions for would-be licensees. They may prevail on the government simply to provide such use in particular cases.[22] They may alternatively prevail on the government to subsidize their ability to pay.[23]

But the basic statutorily mandated rule under Section 154(a)(1) is that patentees have full discretion to elect to exclude all others from practicing whatever is claimed in the patent.[24] The property rule nature of this provision has several beneficial effects.

First, this strong right to exclude is essential for allowing the U.S. patent system to achieve its central goal, which is to provide an economic tool for promoting public access to new technologies.[25] The patent right to exclude use of whatever is covered by the patent

claims operates to increase such use by facilitating ex ante investment in the complex, costly, and risky commercialization activities required to turn nascent inventions into new goods and services. This right to exclude competitors who have not shared in bearing the initial costs of commercialization provides incentives for the holder of the invention and the other players in this market to come together in an organized way and incur the costs necessary to facilitate commercialization of the patented invention.

Second, this strong right to exclude others from using a particular patented technology may have the beneficial effect of inducing even more new technologies. To the extent that some would-be licensees may not be able to obtain permission for use despite manifesting some willingness to pay some positive price,[26] the presence of such potential customers and the potential for an independent patent each provide incentives for others to bring to market some alternative non-infringing substitute.[27]

Third, the ability to exclude use through a patent also provides individual actors with a legal alternative to self-help approaches that may have greater pernicious impact on the ability to obtain use.[28] For example, courts wisely enforce patent licenses that restrict buyers of patented seeds to a single use in producing a commercial crop for harvest – as opposed to allowing the crop to fully mature into subsequent seed – because sellers would alternatively be motivated to employ so-called "terminator technologies" that stop germination but could unintentionally spread to plants for which germination is desired.

Ensuring some particular use determined to be in the public interest – such as ensuring access by scientists to new research tools – through a switch in the patent system towards over-all liability rule treatment should be avoided because the remedies discussed earlier are available, and because such a shift will frustrate the patent system's ability to promote the commercialization of beneficial technologies, including such research tools. The use of liability rules would lead to a net increase in social cost and frustrate the very efforts for ordering and bargaining around patents that are necessary to generate output of patented inventions in the first instance, thereby decreasing over-all social access to new technologies.[29] As recognized by Merges, it is precisely because private parties have a comparative advantage over courts in valuing patents and patented inventions that a property rule is likely to work better than a liability rule according to the established test for choosing between the two types of regimes.[30]

Indeed, patents can be quite effective in easing the breakdowns in exchanges that might take place among members of the basic science community over attempts to exchange cell lines, reagents, or protocols.[31] While a patentee might be motivated to suppress subsequent work in order to avoid criticism, discredit, or helping a competitor, a patentee alternatively might be selfishly motivated to encourage subsequent work in the hope of obtaining peer confirmation and acceptance of the patentee's work and theories, or even simply for fame. More importantly, the essential comparison to be made when evaluating the potential pernicious impact of patents is between the patent regime on one hand and on the other had the alternative regime of no patent availability. There has been a very positive correlation between increased patent activity in the basic biological research community and the enormous growth of the entire biotechnology industry since the 1980 shift in case law through the *Chakrabarty* decision, which spawned the vast use of patents in that sector.[32] The ability for patents to contribute net benefit can be understood through economic models that elucidate the differences between so-called thin markets and thick markets, and suggest that the failed exchanges elucidated by patent critics are types of market failures that are likely to have more pernicious impact in markets that are thinner. In the context of the basic biological science community, the relevant comparison is between the regime in which patents are available for basic biological research and one in which they are not. In the absence of patents, the market in this community can be viewed as a market for kudos.[33] With patents, the market includes both kudos and cash. Scientists are given unfettered access to the entire worldwide financial community through the market characterized by kudos plus patents, which brings immense amounts of, and diversity in sources of, funding and other resources to the basic biological research community. Patents on research tools thereby facilitate rather than frustrate the important exchanges that are in the public interest.

Finally, today's regulators must not disregard the remarkable success the U.S. patent system has enjoyed in achieving its central goal, which is to provide an economic tool for promoting public access to new technologies through their commercialization. The drafters of our present patent system, the 1952 Patent Act, had precisely this concern for commercialization in mind when drafting the statute and were motivated by the specific fear that, for example, the handicapped in need of a recently invented wheelchair might nevertheless not find one available for purchase if the patent system did not provide an incentive for it to be brought to market. In achieving this central goal, the system achieves a number of other important economic objectives, from encouraging investment in capital, to promoting domestic and foreign trade, and making new products and services available to the public. This increases consumer welfare, because consumers get access to more goods and services, and it increases producer welfare because producers make profits. These gains from trade are exactly the key components of total social welfare. Regulators' efforts to squeeze some extra social welfare out of the system by tinkering with the principles of patent law should be mindful of the historical context through which those principles worked their way into our present patent system via Congressional and court action so as to avoid

inadvertently returning our innovation economy to the way it was after the Great Depression of the early 20th Century.

* F. Scott Kieff is John M. Olin Senior Research Fellow in Law, Economics, and Business, Harvard Law School, and Associate Professor, Washington University School of Law. Hon. Gerald J. Mossinghoff is Senior Counsel to the intellectual property law firm of Oblon, Spivak, McClelland, Maier & Neustadt and was formerly Assistant Secretary of Commerce and Commissioner of Patents and Trademarks. Comments are welcome and may be sent to fskieff.91@alum.mit.edu (permanent address).

Footnotes

1. *See*, FTC Press Release: Muris Announces Plans for Intellectual Property Hearings, available at http://www.ftc.gov/opa/2001/11/iprelease.htm (last visited Dec. 15, 2002).

2. *See*, Competition and Intellectual Property Law and Policy in the Knowledge-Based Economy, available at http://www.ftc.gov/opp/intellect/index.htm (last visited Dec. 15, 2002) (home page for the hearings, showing specific dates, topics, and participants for each panel).

3. *See generally*, F. Scott Kieff, *Property Rights and Property Rules for Commercializing Inventions*, 85 Minn. L. Rev. 736-746 (2001) (briefly reviewing history of the patent system through the 20th century with a particular focus on the historical foundation for the present patent system codified in the 1952 Patent Act as a response to the steady erosion of the patent system).

4. *Jurgensen v. Ostby & Barton Co.,* 335 U.S. 560, 572 (1949) (Jackson, J., dissenting).

5. *Graham v. John Deere Co.,* 383 U.S. 1, 17-18 (1965):

> Under § 103 the scope and content of the prior art are to be determined; differences between the prior art and the claims at issue are to be ascertained; and the level of ordinary skill in the pertinent art resolved. Against this background, the obviousness or nonobviousness of the subject matter is determined. Such secondary considerations as commercial success, long felt but unsolved needs, failure of others, etc., might be utilized to give light to the circumstances surrounding the origin of the subject matter sought to be patented. As indicia of obviousness or nonobviousness, these inquiries may have relevancy.

The relevant inquiry for an obviousness determination is whether the prior art as a whole suggested the claimed invention, and indicated to a person having ordinary skill in the art a reasonable expectation of success in achieving the claimed invention. The obviousness requirement exists in addition to the novelty requirement – if an invention is fully disclosed in a single prior art reference it is invalid for lack of novelty under Section 102. Analysis under the Section 103 obviousness requirement operates somewhat similarly to that under the Section 102 novelty requirement; but instead of all elements of the patent claim existing in a single item of prior art (the test for a determination of novelty), a determination of obviousness will lie where the elements of the claim are spread among two or more pieces of prior art, as long as those pieces of prior art also provide a motivation or suggestion to be combined along with a reasonable expectation of success in achieving the claimed invention when combined. See *In re Dow Chem. Co.* 837 F.2d 469 (Fed. Cir. 1988). Although there is some language in the *Graham* opinion to suggest that the 1952 Act did *not change* the law, it is important to note that the opinion ties the statutory objective standard of nonobviousness to 18th century case law that employed a similar objective standard while specifically rejecting the 19th century case law that employed a subjective standard.

6. *Dawson Chem. v. Rohm and Haas,* 448 U.S. 176 (1980), (holding no misuse where the holder of a patent on method of using a chemical as a herbicide charges customers of the herbicide above market price for the chemical itself and sues competing chemical company for contributory infringement).

7. *See*, F. Scott Kieff, In response to the Notice for Public Hearings and Opportunity for Comment, Comments Regarding Competition & Intellectual Property, Summary of Proposed Testimony, *available at* http://www.ftc.gov/os/comments/intelpropertycomments/harvardlaw.pdf (last visited Dec. 10, 2002) (hereinafter Kieff Statement); *see also* Testimony of F. Scott Kieff on April 10, 2002 before joint FTC/DOJ hearings on Competition and Intellectual Property, available at http://www.ftc.gov/opp/intellect/020410trans.pdf (last visited Dec. 10, 2002).

8. *See* Statement of Hon. Gerald J. Mossinghoff Senior Counsel, Oblon, Spivak, McClelland, Maier & Neustadt Presented To The Federal Trade Commission & Department of Justice in Hearings on Competition & Intellectual Property Law and Policy in The Knowledge-Based Economy Feb. 6, 2002 (available at http://www.ftc.gov/os/comments/intelpropertycomments/mossinghoffgeraldj.pdf) (last visited Dec. 10, 2002) (citing *Amazon.com, Inc. v. Barnesandnoble.com, Inc.,* 239 F.3d 1343 (Fed.Cir., 2001)); *see also* Testimony of The Honorable Gerald J. Mossinghoff on Feb. 6, 2002 before joint FTC/DOJ hearings on Competition and Intellectual Property, available at http://www.ftc.gov/opp/intellect/020206ftc.pdf (last visited Dec. 10, 2002) (same).

9. Kieff Statement, *supra* note 7, at 9-10.

10. *See*, *e.g.*, Giles S. Rich, *The Extent of the Protection and Interpretation of Claims—American Perspectives*, 21 Int'l Rev. Indus. Prop. & Copyright L. 497, 499, 501 (1990) (quoted in *Hilton Davis Chem. Co. v. Warner-Jenkinson Co.,* 62 F.3d 1512, 1539 (Plager, J., joined by Archer, J., Rich, J., and Laurie, J., dissenting) (emphasis in original).

11. *See*, *e.g.*, Giles S. Rich, *The Proposed Patent Legislation: Some Comments*, 35 Geo. Wash. L. Rev. 641, 644 (1967) (responding to proposed legislation S. 1042 and H.R. 5924, 90th Cong. (1967) and Report of the President's Commission on the Patent System (1966)).

12. *Id*. (explaining patentee's dilemma, or in his words, "puzzle").

13. Kieff Statement, *supra* note 7, at 10. *See also* Testimony of The Honorable Pauline Newman on Feb. 6, 2002 before joint FTC/DOJ hearings on Competition and Intellectual Property, available at http://www.ftc.gov/opp/intellect/020206ftc.pdf (last visited Dec. 10, 2002) (noting how patentees rationally elect to spend money obtaining and enforcing those patents expected to yield a judgment of validity and infringement).

14. Kieff, *supra* note 3, at 727-32 (showing how the patent system's facilitation of tie-ins and other forms of price discrimination where technological and economic factors alone might prevent price discrimination together provide incentives for the patentee to elect to keep output at competitive levels).

15. *Id*. The prevention of arbitrage is essential for price discrimination to work. For example, those obtaining senior citizen discounts could sell their low price tickets to patrons who would otherwise have to pay full price if movie theatres did not require some proof of age on admission, which may be as simple as looking at the ticket holder.

16. F. Scott Kieff, *Facilitating Scientific Research: Intellectual Property Rights and the Norms of Science - A Response to Rai & Eisenberg*, 95 NW. U. L. Rev. 691, 705 (2001) (discussing a property owner's rational decision to allow free users so as to avoid the cost of monitoring low value uses while preserving the full scope of the property right for other high value uses).

17. Giving away product to the poor will force the patentee to wrestle with a delicate customer-relations balance. On the one hand, paying customers may be offended to learn of the availability of a price that is lower, or even zero. On the other hand, paying customers may be motivated to buy when they learn of both the patented technology's success and the patentee's seemingly charitable contributions. Although it may seem crass to call such a contribution "charitable," since its purpose is the facilitation of some other objective (charg-

ing a higher price to some customers), presumably every donation willingly made to a charitable cause by a rational actor is done to further some objective of that actor and not to further only someone else's objective. While the net impact of these competing forces is uncertain, the patentee's desires to preserve value while avoiding transaction costs that are discussed *infra* note 16 will likely tip the net balance of incentives to be towards the use of such free licenses in certain cases.

18. This argument and its implications are explored in depth in the important works by Eisenberg et al. *See*, *e.g.*, Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCIENCE 698 (1998) (arguing that patents can deter innovation in the field of basic biological research); Rebecca S. Eisenberg, *Property Rights and the Norms of Science in Biotechnology Research*, 97 YALE L.J. 177 (1987) (exploring potential negative impact of patent rights on scientific norms in the field of basic biological research); Rebecca S. Eisenberg, *Patents and the Progress of Science: Exclusive Rights and Experimental Use*, 56 U. CHI. L. REV. 1017 (1989) (exploring an experimental use exemption from patent infringement as a device for alleviating potential negative impact of patent rights on scientific norms in the field of basic biological research); Rebecca S. Eisenberg, *Public Research and Private Development: Patents & Technology Transfer in Government-Sponsored Research*, 82 VA. L. REV. 1663 (1996) (offering preliminary observations about the empirical record of the use of patents in the field of basic biological research and recommending a retreat from present government policies of promoting patents in that field).

19. An entitlement enjoys the protection of a property rule if the law condones its surrender only through voluntary exchange. The holder of such an entitlement is allowed to enjoin infringement. An entitlement has the lesser protection of a liability rule if it can be lost lawfully to anyone willing to pay some court-determined compensation. The holder of such an entitlement is only entitled to damages caused by infringement. *See* Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972); *see also* Jules L. Coleman & Jody Kraus, *Rethinking the Theory of Legal Rights*, 95 YALE L.J. 1335 (1986).

20. 28 U.S.C. § 1498 (1994) (providing limited waiver of sovereign immunity for acts of infringement by or for the federal government and instead allowing suits against the government in the U.S. Court of Federal Claims for a reasonable royalty).

21. As explained more fully in Kieff, *supra* note 3:

Concerning procedure, litigation costs may be high enough to prevent the patentee from seeking court intervention against an infringer. Concerning substance, the limitations on liability that are available to a would-be infringer through the use of the corporate form or bankruptcy laws, for example, may encourage acts of infringements that are essentially judgment proof.

Id. at 734 n.154.

22. *See supra* text accompanying note 20. The recent public demand for the patented drug Cipro® to treat anthrax infection provides an example from the healthcare arena of just such behavior. *See*, *e.g.*, Terence Chea, *Vaccines Are Hot Topic, But Not Hot Investment*, WASH. POST, Dec. 13, 2001, at E1. "At the height of the anthrax crisis, government officials considered overriding German drugmaker Bayer AG's Cipro patent to purchase pills at a better price. Under threat of losing its patent, Bayer agreed to sell the government the antibiotic at half price." *Id*.

23. *See* Douglas Gary Lichtman, *Pricing Prozac: Why the Government Should Subsidize the Purchase of Patented Pharmaceuticals*, 11 HARV. J.L. & TECH. 123, 124-25 (1997) (arguing that the government should offer a cash subsidy to any consumer who values a patented good above marginal cost but is unwilling or unable to pay to such a price). *Cf.* Kieff, *supra* note 3, at 716 n.91 (noting that such proposals face the distortion and implementation concerns generally raised against subsidies).

24. While patentees are free to elect to give permission for such use, which is called giving a license, at present under U.S. law, patentees are not compelled to license anyone, including members of the basic science community. Nor does present U.S. law afford any type of fair use or *pro bono publico* exception that might otherwise exempt members of that community from liability.

25. Kieff, *supra* note 3 (showing the patent right to exclude is essential for ensuring commercialization of new technologies).

26. *See id*. at 731 (discussing possibility that some licensees may not be able to obtain permission to use the patented invention).

27. *See* DONALD S. CHISUM ET AL., PRINCIPLES OF PATENT LAW 75-76 (2d ed. 2001) 75-76 (discussing incentive to design around patented inventions).

28. F. Scott Kieff, *Patents for Environmentalists*, 9 WASH. U.J.L. & POL'Y 307, 315-317 (Invited symposium piece for National Association of Environmental Law Societies annual meeting, March 15-17, 2002 at Washington University School of Law) (discussing benefits of patents over self help).

29. Kieff, *supra* note 3, at 732-36 (showing how the potential infringements induced by a liability rule will discourage investment in the commercialization process *ex ante* and may even result in a net destruction of social wealth if the collective costs of entry and exit across infringers exceed the social surplus otherwise created by the invention).

30. *Id*. at 734 n.152. (citing Robert P. Merges, *Of Property Rules, Coase, and Intellectual Property*, 94 COLUM. L. REV. 2655, 2664 (1994)).

31. *See*, F. Scott Kieff, *Facilitating Scientific Research: Intellectual Property Rights and the Norms of Science - A Response to Rai & Eisenberg*, 95 NW. U. L. REV. 691 (2001).

32. *See Diamond v. Chakrabarty,* 447 U.S. 303 (1980) (holding living organisms not per se unpatentable).

33. It is well recognized that scientists generally have treated reports of a scientist's work as a form of intellectual property, serving as one type of currency in the market for scientific kudos. *See*, *e.g.*, Jerome R. Ravetz, SCIENTIFIC KNOWLEDGE AND ITS SOCIAL PROBLEMS 245 (1996). Kudos can take many forms, including publication in prestigious journals, citation by peers, general prestige, the award of research grants, academic appointments and tenure, and salary. *Id*. at 245-72. And scientists have demonstrated countless ingenious methods for staking out, defending, and even pirating this form of intellectual property. Market failures would be expected to be worse in the market for only scientific kudos for at least three reasons: kudos are much less fungible; there are fewer potential valuators; and there is less total fungible wealth.

Labor & Employment Law

Working Hard or Hardly Working?

*By David G. Evans**

California is a worker's paradise when it comes to taking time off from work. The Golden State provides for family leave under the California Family Rights Act (CFRA). The CFRA, as well as the federal Family and Medical Leave Act (FMLA), entitle eligible employees to take unpaid, job-protected leave for up to 12 workweeks in a 12-month period. The State also has laws for school appearance leave (up to 40 hours a year to participate in a child's school activities), alcohol and drug rehabilitation leave, and pregnancy leave – not to mention indefinite leaves under the State's workers' compensation system for work-related injuries and illnesses.

Recently the California Legislature passed a *paid* family leave law that creates a "family temporary disability insurance program." The very first of such state laws (taking effect on July 1, 2004), the FTDI law promises to be a nightmare for employers and employees, and an opportunity for those who want to get paid for not working. It also has some disturbing privacy issues that should give heartburn to the ACLU. (The fact that the ACLU supported the law is further evidence that the organization has veered from its original pursuit of civil liberties protection to new goals of "economic justice.")

Let me say at the outset that I fully support voluntarily provided paid or unpaid leave and other policies that would assist employees in balancing the demands of work and family. I have two kids, I had elderly ill parents, and I had a major illness. I know how tough it can be to balance the demands of work and family life. However, the California approach just goes too far and it is a major government intrusion on medical privacy.

An organization that is taking California to task on the new law is the National FMLA Technical Corrections Coalition. The Coalition is a nonpartisan group of companies, human resource professionals, and associations dedicated to making the practical application of the FMLA more consistent with its original intent. The Coalition was founded by the Society for Human Resource Mangement (SHRM).[1] Deanna R. Gelak, the Coalition's Executive Director, makes a compelling case against the California law.[2] The Coalition's arguments are summarized below.

The intent of the new FTDI program is to help reconcile the demands of work and family. Existing law provides for disability compensation payments for wage loss sustained by an individual unemployed because of sickness or injury. The compensation is financed by employee contributions at specified rates to a state-managed disability fund. The current state disability insurance benefits provide wage replacement for workers who need time off due to their own non-work related injuries, illnesses or conditions, including pregnancy, that prevent them from working; but they do not cover leave to care for a sick or injured child, spouse, parent, domestic partner,[3] or to bond with a new child.

The new FTDI program will be a component of the State's existing unemployment compensation disability insurance program; it will be funded through employee contributions, and administered in accordance with the policies of the state disability insurance program. The new law creates, within the state disability insurance program, a family temporary disability insurance program to provide up to six weeks of wage replacement benefits (after a 7 day waiting period) to workers who take time off work either to care for a seriously ill child, spouse, parent, domestic partner, or to bond with a new child. Benefits are payable for leaves that begin on and after July 1, 2004.

An individual entitled to leave under the FMLA and the CFRA must take the family temporary disability insurance leave concurrent with leave taken under the FMLA and the CFRA. However, the new paid family leave program does not run concurrently with California's Pregnancy Disability Leave. The law permits employers to require that employees use up to 2 weeks of earned but unused vacation leave before that employee's receipt of the additional benefits.

The new program is much broader than other leave laws in many important respects. For instance:

1. The law covers all employers regardless of size. There is no small business exemption (Mom and Pop businesses are included);
2. There is no vesting requirement. If an employee is on-the-job just one day, he is entitled to take paid leave);
3. There is no key employee exemption (employees essential to company operations can take off); and
4. The medical certification the employee must obtain in order to qualify for leave goes to California's government, not to the employer. As such, there is no opportunity for employer to verify or challenge the need for leave. (In addition, the law will place an individual's confidential medical information in the hands of the government.)

Although the law was billed as not providing job protection, it does. Pursuant to California Unemployment Insurance Code Section 1237, "Retaliation for Contact with State Authorities," employees applying for the new paid family leave program will have protection against retaliation/termination by virtue of the fact that they "contacted" the California Employment Development Department.

Under the new law intermittent leave is permitted and can be taken in the smallest amounts of time by which an employer calculates pay. Experience with federal FMLA intermittent leave tracking shows that California will have a difficult (I'd say impossible) time accurately tracking the

increments of leave – which, in turn, will create problems in making over- and underpayments.

The medical certification that will be sent to the state will contain information about the employee's sickness, injury, or pregnancy; and, a diagnosis and diagnostic code prescribed in the International Classification of Diseases, or, where no diagnosis has yet been obtained, a detailed statement of symptoms.[4] The certification will also have a statement of medical facts within the physician's or practitioner's knowledge based on a physical examination, a documented medical history of the employee by the physician or practitioner indicating his conclusion as to the employee's disability, and a statement of the physician's or practitioner's opinion as to the expected duration of the disability.

For the serious health condition of a family member, employees will need a diagnosis and diagnostic code prescribed in the International Classification of Diseases, or, where no diagnosis has yet been obtained, a detailed statement of symptoms; the date, if known, on which the condition commenced and the probable duration of the condition; and an estimate of the amount of time that the physician or practitioner believes the employee is needed to care for the child, parent, spouse, or domestic partner. There also must be a statement that the serious health condition warrants the participation of the employee to provide care for his or her child, parent, spouse, or domestic partner. "Warrants the participation of the employee" includes, but is not limited to, providing psychological comfort, and arranging third-party care, for the child, parent, spouse or domestic partner as well as directly providing or participating in the medical care.

The California medical certification is far more intrusive than the certification required by the FMLA and the CFRA. In addition, the FMLA and CFRA certification forms only go to the employer, and the employer is required by law to maintain confidentiality protections. The FTDI program's forms go directly to the government.

Employers have little protection from false claims. Existing California law makes it unlawful to falsely certify the medical condition of any person in order to obtain disability benefits, to knowingly present a false statement in support of a claim for benefits, to knowingly solicit or receive any payment for soliciting a claimant to apply for disability insurance benefits, or to assist any person who engages in certain specified fraudulent or prohibited actions. The new program is subject to the above proscriptions; however, this provision will likely go unenforced unless the state hires an army of bureaucrats.

This state funded or administered paid leave program will require massive administrative and personnel resources. The resources that employers currently divert in tracking segments of the FMLA by the minute provide a preview of the administrative complexity that California will experience under this State-enforced, mandated paid leave system. With the FMLA, human resource staff are consumed by "administrivia" and minute counting, drawing away from time spent developing progressive programs, policies and practices.

The California law will foster employee resentment in two major ways.

First, the mandatory employee payroll taxes are a direct cost to all employees. This new economic burden will foster resentment among those employees who cannot afford to participate and who do not need or benefit from the program.

Secondly, research shows that the primary method used by employers to cover for FMLA absences is to assign the absent employee's work to co-workers. One study[5] estimates that, on average, 60% of employees taking FMLA leave do not schedule the leave in advance. As a result, HR staff often lack the ability to plan for work disruptions. HR professionals (34%) report employee complaints in the past 12 months due to co-workers' questionable use of FMLA. Employees do not mind when the leave is legitimate, but the current state of the law under the FMLA (i.e., overbroad interpretations and legal confusion) tempts employees to mischaracterize absences as FMLA protected leaves. California's new law will only exacerbate such misunderstandings and abuses of leave. Furthermore, employers will have limited ability to correct abuses because the system will be administered by the state.

The Coalition recommends that, given the existence of privately funded leave and the FMLA, voluntary incentives to increase the provision of paid leave will work better and will cause fewer negative consequences, less confusion and legal challenges than the government-administered leave and its attendant bureaucracy and mandates. This approach can be accomplished by building on voluntarily provided private sector paid leave policies through a targeted incentive or savings program. Incentive approaches also will avoid raising the privacy concerns implicated by the government tracking and presumably verifying leaves under the new law.

The best approach is to preserve and foster competition among employers for providing paid leave policies, flexible schedules and creative benefits. We must not usurp the competitive free enterprise spirit by creating a system where the government takes over, removing all such incentives for employers to "do more" for their workforce. All government mandates eventually become viewed as entitlements – with the government as the benefactor rather than the employer.

The Coalition recommends the following alternative steps:

1. Enact a tax incentive for companies to expand their employment leave policies to provide paid leave.
2. Enact a family and medical leave savings account provision at the state level, similar to the federal 401(K) program, to allow employees to place funds into a tax-deferred family leave savings account. An incentive can be created for employers to match the employee's family and medical leave contributions.

This recommended approach does not create a new tax or the big government leave tracking system found in the California approach. Lacking the unnecessary divisiveness, expense

and bureaucracy of the mandated system, this approach would more effectively accomplish the goal of increasing the availability of paid leave for employees. The approach enjoys the added benefit of constructively building on existing private sector funded leaves without replacing private sector dollars with government funds. Furthermore, it avoids adding the burden of an unnecessary, enormously costly and ultimately inefficient government leave administration and tracking function to the state's financial concerns. Incentive systems are also more of a "win-win" for employees and employers – as opposed to government paid leave entitlements, which foster ill-will between employees and employers and invite misapplication and abuse.

The California paid leave law will have grave unintended consequences for the State's economy, the workplace (small businesses in particular), the privacy rights of the citizens of the State, and the government agency charged with administering and tracking leave under such a poorly conceived plan. The FTDI program will result in a maze of ambiguous leave complexities, employee morale problems, and costs for California employers already challenged in their good faith attempts to comply with the various laws and to provide their own competitive benefits.

*David G. Evans practices in the areas of employment law and governmental affairs. He is the author of five books on the law, including: *Federal and State Guide to Employee Medical Leave Benefits and Disabilities Laws; Designing an Effective Drug-Free Workplace Compliance Program;* and *Drug Testing Law, Technology, and Practice* published by the West Group (www.westgroup.com).

Footnotes

[1] To get the full text of the Coalition's materials, visit its website at: http://www.Workingforthefuture.org. The Coalition's address is: National FMLA Technical Corrections Coalition, 7505 Inzer Street, Springfield, VA 22151, (703) 256-0829. The Coalition also provides assistance to employers in FMLA compliance.

[2] See Testimony of Deanna R. Gelak, SPHR, Executive Director, National FMLA Technical Corrections Coalition, Presented to the Oregon Legislature's Paid Family Leave Task Force, Oregon State Capitol, October 3, 2002; Summary and Analysis of California Senate Bill No. 1661 by Senator Kuehl, As Passed by the Assembly, August 28, 2002; letter to The Honorable Gray Davis, RE: Senate Bill No. 166, September 16, 2002

[3] California Family Code Section 297 defines domestic partner as two adults who have chosen to share one another's lives in an intimate and committed relationship of mutual caring where both persons have a common residence (even if one or both have additional residences), both persons agree to be jointly responsible for each other's basic living expenses incurred during the domestic partnership, neither person is married or a member of another domestic partnership, the two persons are not related by blood in a way that would prevent them from being married to each other in this state, and both persons are at least 18 years of age.

[4] In California you can get "medical" marijuana by describing "symptoms" over the phone to a doctor.

[5] The Society for Human Resource Management (SHRM®) 2000 FMLA Survey, p. 14 Chart 7.

WAFFLING CIRCUITS: WORKPLACE ADR AFTER *CIRCUIT CITY* AND *WAFFLE HOUSE*

*BY FRANCIS T. COLEMAN**

From a legal standpoint, alternate dispute resolution ("ADR") agreements in the workplace have exhilarated HR and employment law. During the last decade, more and more employers have added ADR to their workplace lexicons. Employers of all sizes and descriptions seek alternatives to the high costs of litigation, and many have chosen the ADR approach as their answer.

Two recent United States Supreme Court cases, *Circuit City* and *Waffle House*, may seem, on their faces, to send muddled signals as to whether courts will enforce such agreements. Now that the dust has settled, however, a clear answer is emerging. Yes, courts will enforce mandatory ADR agreements in the workplace, so long as they meet minimum standards of fairness and due process.

This article first defines workplace ADR. Second, the article describes the decisions by which the United States Supreme Court has communicated its overall willingness to enforce mandatory ADR agreements. Third, the article describes minimum standards required for such judicial enforcement. Fourth, the article examines pros and cons of adopting an ADR policy in the employment context, given the current judicial landscape. Finally, the article concludes that, for 2003 and beyond, ADR fits the needs of most organizations. The Circuits are no longer waffling.

I. A Definition of Workplace ADR

Before tackling the legalities and enforceability of ADR choices, one must first grasp the basics. What is workplace ADR, and how does it work? Workplace ADR arises out of contractual agreements whereby prospective and/or current employees agree to resolve specified workplace-related disputes (including disputes arising from the termination of employment) by arbitration, mediation or other non-judicial methods, rather than by litigation. Typically, employers make such agreements a condition of employment for applicants, and many employers also make them apply to current employees.

Not everyone is in love with these agreements. In fact, the Equal Employment Opportunity Commission ("EEOC"), plaintiff trial lawyers and civil rights groups have mobilized in opposing them, thus making ADR not only one of the most important developments of the last ten years but also one of the most controversial. This struggle between proponents and detractors has produced a long and hotly contested series of court battles as to the agreements' legality and enforceability. Although the United States Supreme Court has not yet resolved all issues surrounding ADR in the workplace, proponents appear, at least for now, to have succeeded in their defense of these agreements, provided they do not overplay their hand.

II. Recent Supreme Court and Other Decisions Permitting Workplace ADR

Supreme Court decisions dating back to the 1960's expressed pro-arbitration preferences. In *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*,[1] for example, the Court held that, under the United States Arbitration Act, arbitrators under an arbitration clause had power to hear even a claim of fraud inducing the contract itself. Also in the early 1960's, the high Court issued its famous trilogy of decisions supporting the arbitrability of workplace disputes.[2] Within the past year, the Supreme Court has shed new light on the subject, even if some have not yet seen that light, or if, having seen it, they have emphasized only the new shadows it casts. Two important decisions have defined the scope of ADR agreements and their enforceability in the workplace.

A. Supreme Court's Decision in *Circuit City (Part I)*

In keeping with the pro-arbitration line of cases, the Supreme Court on March 22, 2001 upheld the enforceability, under the Federal Arbitration Act ("FAA"), of employment agreements requiring arbitration of workplace disputes as a substitute for employment litigation.[3] The *Circuit City I* decision upheld the majority of federal Courts of Appeal that had previously ruled on the issue. In essence, the Court held that both the public policy favoring arbitration and the language of the FAA itself required a narrow construction of the statute's exclusion of employment contracts. In reaching this conclusion, the Court held that the statute's excepting from its scope "contracts of employment of seamen, railroad employees, or any other class of worker engaged in foreign or interstate commerce" excluded from arbitration only those employees actually transporting goods in interstate commerce.[4] Thus, concluded the Court, the statute covered all other employment contracts, and they were therefore enforceable under its provisions.

Members of Congress on both sides of the aisle jockeyed legislatively both in anticipation of and reaction to the holding of *Circuit City I*. On March 1, 2001, for example, three weeks before the decision, Congressman Robert E. Andrews (D—NJ) introduced a bill that would amend 9 U.S.C. to let employees, within 60 days of initiating an employment controversy, reject the use of arbitration, notwithstanding a mandatory ADR agreement.[5] Even earlier, on January 24, 2001, Senators Russ Feingold (D—WI), Patrick Leahy (D—VT), Edward M. Kennedy (D—MA) and Robert G. Torricelli (D—NJ) had introduced a bill that would amend certain federal civil rights statutes to prevent involuntary arbitration of claims arising from unlawful employment discrimination.[6]

Then came *Circuit City I*. Just two weeks later, on April 4, 2001, Congressman Edward J. Markey (D—MA) introduced a House version of the Feingold bill.[7] On September 18, 2001, Congressman Dennis J. Kucinich (D—OH) introduced a bill that would amend 9 U.S.C. to exclude all employment contracts from the arbitration provisions of chapter one of that title.[8] Senators Kennedy and Feingold introduced a Senate version of Kucinich's bill on May 5, 2002.[9] And on October 1, 2002, Senator Jeff Sessions (R—AL) introduced a bill that would amend the first chapter of 9

U.S.C. to provide for greater fairness in the arbitration process.[10]

Despite all this legislative posturing, and although the Court's vote was close (5 to 4), arbitration proponents celebrated victory after *Circuit City I*. Employers saw *Circuit City I* as a green light for making employees sign an ADR agreement as a condition of employment, provided such agreements met minimum standards of fairness and due process.

B. Supreme Court's Decision in *Waffle House*

Proponents of workplace ADR did not savor their victory for long, however, before the Supreme Court issued another major decision addressing ADR agreements. The *Waffle House* decision[11] considered the EEOC's authority to seek relief on behalf of individuals who had previously signed enforceable ADR agreements. On January 15, 2002, the Supreme Court in a 6-3 decision ruled that an arbitration agreement made by a South Carolina restaurant employee and his employer did not prevent the EEOC from pursuing—on the employee's behalf—victim-specific judicial relief based on an Americans with Disabilities Act ("ADA") claim.

Writing for the majority in reversing a decision by the U.S. Court of Appeals for the Fourth Circuit, Justice John Paul Stevens stated that, despite the FAA's preference for arbitration, once a charge is filed with the EEOC the Commission "is in command of the process."[12] Private arbitration agreements to which the EEOC was not a party, he wrote, did not bind it.[13] It was therefore entitled to seek even victim-specific relief—i.e., reinstatement, backpay, injunctive relief and punitive damages.[14]

> In reaching its decision, the Court left open the question of whether a private settlement by the parties or a prior arbitration award would affect the scope of the EEOC's claim or the relief requested. The Court also left open the question of whether it could halt an ongoing arbitration while the EEOC litigated the employee's claim.

Naturally, the *Waffle House* decision received different receptions from ADR's proponents and detractors. Expectedly and understandably, the decision thrilled the EEOC. EEOC Chair Cari M. Dominguez stated that the decision "reaffirms the significance of the EEOC's public enforcement role" and observed that the EEOC, as the agency responsible for enforcing antidiscrimination laws, "is not constrained in any way by a private arbitration agreement to which EEOC is not a party."

ADR proponents, on the other hand, downplayed the decision, observing that it would have little impact because the EEOC initiated litigation only infrequently. Given its budgetary and staff limitations, the EEOC litigates only major cases, involving major employers, novel issues, large class-action matters or charges of systemic discrimination. New York University Professor Samuel Estreicher observed that the decision allowed the EEOC to continue "creating nuisance" when arbitration agreements existed, without providing significant relief for most people who brought charges. Continuing, Professor Estreicher noted that, "The decision injects an element of legal uncertainty for employers using arbitration agreements and could prevent arbitrators from reaching decisions because of concerns EEOC may become involved."

Although, as Professor Estreicher notes, the *Waffle House* decision does inject an element of uncertainty as to the finality of any arbitration proceeding under an ADR agreement or settlements reached as a result thereof, an ADR agreement still remains, in the author's opinion, an attractive alternative to litigation. The small number of EEOC-initiated lawsuits bolsters this assessment. For example, during FY 2000, the EEOC filed a total of only 327 lawsuits, a very small percentage of the charges filed with the Commission. This pattern of prosecutorial restraint will probably continue in 2003 and beyond, as the Bush administration will not likely add to the Commission's limited litigation budget.

The Department of Labor has exercised similar restraint in the wake of *Waffle House*. On August 9, 2002, a directive issued by Solicitor of Labor Eugene Scalia welcomed the case's "affirmation of the government's litigation authority." The directive also, however, acknowledged "a tradition of federal employment agencies deferring to arbitration in appropriate circumstances" and listed factors that agency attorneys must consider when deciding whether to litigate a matter subject to an ADR agreement. These factors included: the dispute's relationship to the Labor Department's mission; the agreement's validity; the arbitration's costs; the arbitrator's qualifications, selection, and procedural and substantive authority; and the arbitration's procedural posture.

In short, the U.S. government seems inclined to leave arbitration agreements, where they exist, as the controlling method for resolving most workplace claims covered by ADR. While employers rightly view the *Waffle House* decision as a step backwards, it appears to be a tiny step backwards and should not deter such agreements in the future.

C. Ninth Circuit's Decision in *Circuit City (Part II)*

On June 3, 2002, in *Circuit City II*, decided on remand from the Supreme Court's *Circuit City I* decision above, the U.S. Court of Appeals for the Ninth Circuit held that a contract of adhesion offered on a take-it-or-leave-it basis is unconscionable under California law.[15] Although *Circuit City I* had overruled the Ninth Circuit's position that the FAA does not apply to employment contracts generally, the Ninth Circuit once again refused to enforce Circuit City's ADR agreement. This time the Ninth Circuit reasoned that the ADR agreement was a contract of adhesion, offered on a take-it-or-leave-it basis between parties of highly unequal bargaining power. State law therefore rendered the agreement both procedurally and substantively unconscionable.

In considering the agreement's procedural unconscionability, the Ninth Circuit focused on the disequilibrium of bargaining power between the parties, the non-negotiability of its terms, and the extent to which the contract did not clearly disclose what rights the employee was relinquishing. The Ninth Circuit ultimately concluded that the company's

pre-employment ADR agreement "function[ed] as a thumb on Circuit City's side of the scale." Additionally, the Court noted that while all of the *employee's* employment-related claims were subject to arbitration, the *employer's* claims were not bound by the same requirements. The court also observed that the agreement limited the available injunctive and other types of statutory relief—thus contrasting with the relief a plaintiff might get in a civil suit for the same causes of action. Finally, the agreement required the employee to split the arbitrator's fees with Circuit City. This fee allocation scheme alone, the court stated, made the agreement unenforceable.

Plaintiffs have frequently raised the contract-of-adhesion defense in other jurisdictions, and, as was the case with the Ninth Circuit's position on the applicability of the FAA, a great majority of courts that have ruled on the issue have rejected it. Nonetheless, this case does underscore the necessity of reviewing the law in the applicable jurisdiction before drafting and adopting an ADR agreement.

D. Other Decisions Finding Mandatory ADR Agreements Enforceable

Since the Supreme Court's decisions in *Circuit City I* and *Waffle House*, other courts, including the Ninth Circuit, have endorsed the enforceability of mandatory ADR agreements between employers and employees.

In *EEOC v. Luce*, from September 2002, the Ninth Circuit Court of Appeals, though divided, finally joined the great majority of the other federal Courts of Appeal, upholding the enforceability of mandatory arbitration of Title VII discrimination claims.[16] Reversing an earlier decision, the *Luce* court held that, in view of *Circuit City I*, a firm previously enjoined from making employees arbitrate Title VII claims could now make employees sign ADR agreements as a condition of employment and could enforce those agreements against current employees. In reaching its decision, the *Luce* court concluded that the Supreme Court's decision in *Circuit City I* "decimated" any inference that Congress intended to preclude compulsory arbitration of Title VII claims. *Luce* is an important decision, because the Ninth Circuit was one of the last federal appellate holdouts in opposing the green light for mandatory arbitration agreements in the workplace. Now, all federal Circuits and many state supreme courts have approved such agreements, with greater or fewer restrictions.

In *Adkins v. Labor Ready, Inc.,* for example, the U.S. Court of Appeals for the Fourth Circuit held that the plaintiff's ADR agreement with a temporary employment-agency barred him from bringing any FLSA suit alleging faulty payroll procedures, because the FLSA did not pre-empt the FAA.[17] In *Tinder v. Pinkerton Security*, the U.S. Court of Appeals for the Seventh Circuit ordered an at-will employee to submit her sex discrimination and retaliation claims to arbitration, because her continued employment and the company's promise to arbitrate constituted valid consideration, even though she began working before the company's ADR plan existed.[18] In *Brown v. Illinois Central Railroad Co.,* the same circuit held that the Railway Labor Act's mandatory ADR provision barred a railroad employee from litigating an ADA claim, because resolving the ADA accommodation issue involved interpreting the seniority provisions of a collective bargaining agreement.[19] In *Weeks v. Harden Manufacturing Corp.,* the U.S. Court of Appeals for the Eleventh Circuit permitted an employer to terminate four employees who refused to sign a mandatory ADR provision covering all Title VII, ADA and ADEA claims, because the employees could not reasonably have believed the provision to be illegal, even if a court were later to find it unenforceable.[20] In *Martindale v. Sandvik Inc.*, a divided New Jersey Supreme Court held that an ADR agreement contained in a job application form did not constitute a contract of adhesion, because the prospective employee was an experienced benefits administrator.[21] In *In re Halliburton Co.*, the Supreme Court of Texas held that, by continuing to work after an employer had sent notice of its new ADR program, an at-will employee accepted the program, for which the employer's promise to arbitrate disputes constituted adequate consideration.[22] And in *Barnica v. Kenai Peninsula Borough School District*, a divided Alaska Supreme Court held that the ADR clause in a collective bargaining agreement covered a former employee's sex discrimination claim under state law, because the discrimination statute's legislative history did not show an intent to prevent an employee from waiving her judicial remedy.[23]

In each instance, courts enforced carefully crafted ADR agreements in the workplace.

III. Minimal Standards Required for Judicial Enforcement

Although various courts have sent mixed signals regarding the enforceability of mandatory ADR agreements, the courts are slowly beginning to establish criteria that, if followed, will ensure legality and enforceability. Indeed, the majority of reviewing courts have enforced workplace ADR agreements and in the process have laid down guidelines for the enforceability of such agreements. These requirements may vary from jurisdiction to jurisdiction, so the language and conditions set forth in ADR agreements must meet the judicial requirements of the applicable jurisdiction(s). Furthermore, the law of workplace ADR continues to evolve, and the U.S. Supreme Court has not finally resolved all possible issues. Nonetheless, at this writing, the courts have consistently examined certain areas to determine whether challenged ADR agreements meet minimal standards of fairness and due process. Some of the most frequently imposed restrictions appear below.

As a general rule, courts enforcing mandatory arbitration agreements have required that such agreements:

A. Be in Writing and Clearly Set Forth the Terms of the Agreement

The New Jersey case of *Garfinkel v. Morristown Obstetrics and Gynecology Associates* illustrates this point.[24] The plaintiff, a physician formerly associated with an obstetrics and gynecology practice, claimed that the practice unlawfully discharged him because he was a male. Before joining the practice, the plaintiff signed a written employment agreement which stated that "any controversy arising out of, or relating to, this Agreement or the breach thereof, shall be settled by arbitration." The plaintiff filed suit in the

New Jersey Superior Court under the New Jersey Law Against Discrimination (LAD). The Court upheld the plaintiff's right to sue in court despite his written agreement to arbitrate. The plaintiff, the Court found, had not clearly and unambiguously waived his rights under the LAD. In reaching its conclusion the Court stated, "The Court will not assume that employees intend to waive those rights unless their agreements so provide in unambiguous terms." The Court further stated that a waiver-of-rights provision "should at least provide that the employee agrees to arbitrate all statutory claims arising out of the employment relationship or its termination. It should also reflect the employee's general understanding of the type of claims included in the waiver, e.g., work place discrimination claims."

Similarly, in *Dumais v. American Golf Corp.*, the U.S. Court of Appeals for the Tenth Circuit found illusory and unenforceable a mandatory ADR agreement with conflicting provisions, because the employee handbook arguably empowered the employer to change the agreement without notice.[25]

B. Provide Employees Same Relief Available In Court

Courts generally require that arbitration agreements provide the arbitrator with the authority to award the employees the same relief that would have been available to them had they gone to court to pursue their claims under various federal, state or local laws. Such relief might include backpay, compensatory and punitive damages, injunctive relief, reinstatement, attorney fees, expert witness fees, etc. In short, the agreement should give the arbitrator authority to fashion any remedy s/he feels appropriate: as one opinion put it, to award "all the types of relief that would otherwise be available."[26]

C. Provide Procedural Fairness By Allowing Pre-hearing Discovery Rights

One safe course would be to authorize what the Revised Uniform Arbitration Act calls "adequate" discovery or discovery "appropriate in the circumstances," which the arbitrator would determine.[27] In *Bailey v. Ameriquest Mortgage Co.,* the U.S. District Court for the District of Minnesota refused to stay a discovery order pending the defendant's appeal of the court's decision not to compel arbitration.[28] Although the plaintiffs had signed a mandatory ADR agreement, the court reasoned, discovery would cause the defendant to suffer little, if any, prejudice.[29] In *Blair v. Scott Specialty Gases*, the U.S. Court of Appeals for the Third Circuit held, first, that the ADR provision in an employee handbook was enforceable, because the company's promise to arbitrate constituted adequate consideration, even though the employer could unilaterally amend the agreement and the employee would have to split arbitration's costs.[30] The *Blair* court also held, however, that the plaintiff was entitled to discovery on costs, because only thus could she test her claim that the fee-splitting provision made the agreement unenforceable.[31]

D. Provide Limited Judicial Review of Arbitrator's Decision

Such a provision ensures that the arbitrator's decision is in accordance with the law and that the arbitrator acted within the scope of his or her authority. Reviewing courts generally will overturn an arbitration decision only where the arbitrator has exceeded the scope of his or her authority, where fraud has occurred, or where the decision itself reveals a "manifest disregard of the law."

E. Do Not Impose Undue Financial Burden On Employee For Pursuing Arbitration Process

Many courts have refused to enforce agreements containing provisions that make employees pay for mandatory arbitration, because such provisions arguably discourage pursuit of genuine disputes. In *Cole v. Burns International Security Service,* for example, the U.S. Court of Appeals for the District of Columbia held that the employer must pay the entire cost of the arbitrator's fee, because had the matter been litigated the employee would not have been required to pay any fees other than minimal court costs.[32] In *Bond v. Twin Cities Carpenters Pension Fund*, a divided U.S. Court of Appeals for the Eighth Circuit ruled that a pension plan's requiring a participant to share the costs of mandatory ADR violated ERISA, because the provision discouraged pursuit of legitimate claims.[33] In *Ferguson v. Countrywide Credit Industries*, the U.S. Court of Appeals for the Ninth Circuit found an ADR agreement procedurally and substantively unconscionable and unenforceable under California law, because the agreement tried to split fees, limit discovery and exclude certain types of claim.[34] In *Gambardella v. Pentec, Inc.,* the U.S. District Court for the District of Connecticut held, first, that a former employee's Title VII claims against fellow employees were subject to arbitration, because these claims arose out of the employer-former employee relationship, even though fellow employees did not sign the employer's-former employee's ADR agreement.[35] Second, the *Gambardella* court held that a clause making each party pay its own legal fees rendered the agreement unenforceable.[36] And in *Perez v. Globe Airport Security Service, Inc.,* the U.S. Court of Appeals for the Eleventh Circuit initially held that the plaintiff did not have to arbitrate her gender-discrimination claim, because the employer's ADR agreement would split fees in all situations, whereas Title VII shifted fees when a plaintiff prevailed.[37] (Nine months later, however, the court vacated its opinion, when the parties moved jointly to dismiss the appeal with prejudice.[38]) All these cases preach a single lesson. To be judicially enforceable, a mandatory ADR agreement must not burden the employee with costs that would make pursuing arbitration financially prohibitive.

In determining what would be a fair cost to impose on the employee, however, other courts have examined the employee's ability to pay. In *Green Tree Financial Corp.-Ala v. Randolph*, for example, the U.S. Supreme Court found that an arbitration agreement's not mentioning arbitration costs and fees did not render it unenforceable per se because it had failed affirmatively to protect a party from potentially steep arbitration costs.[39] Similarly, in *Goodman v. ESPE Am. Inc*., the U.S. District Court for the Eastern District of Pennsylvania held that the "loser pays" provision in a mandatory

ADR agreement was enforceable and did not deny Plaintiff an effective and accessible forum, because the provision by its terms made the plaintiff not liable for *any* costs at *any* time if the plaintiff's claim succeeded.[40]

F. Comply With State Law

On September 30, 2002, California Governor Gray Davis vetoed a bill that would have prohibited an employer's mandatory ADR agreement from requiring an employee to waive rights that the state's fair-employment-and-housing statute guaranteed. Employers must heed such legislative developments to ensure that their ADR agreements meet all statutory requirements under the law governing the transaction.

IV. Evaluating Workplace ADR: Criteria for Employers and Employees Alike

Assuming that one *can* craft an enforceable workplace ADR agreement, *should* one? This author's answer is a qualified "yes, but he concedes that in certain situations his answer may be otherwise. For example, arbitration is probably inappropriate where either party needs or desires a definitive or authoritative resolution of the matter for its precedential value or to maintain established norms and especially important policies. Similarly, if one case significantly affects persons who are not parties to the proceeding, arbitration may not fully resolve the dispute. Sometimes, employers and employees require a full public record of the proceeding.

The following advantages and disadvantages potentially attend workplace ADR, depending on the situation.

A. Advantages

Let us consider first the advantages, because in most instances they are more numerous. A well-conceived and well-executed workplace ADR program ordinarily:

1. Saves money.

Arbitration usually costs far less than litigation, for both employer and employee. This is true even if the employer pays all or substantially all of the costs associated with arbitration. Attorneys' fees for litigating an employment-related lawsuit frequently run into six figures. On the other hand, legal representation at an arbitration proceeding, except in complex and unusual cases, averages between $10,000 and $15,000, sometimes even less. A recent ADR survey of 20 Fortune 500 companies found that the cost of handling cases that went to arbitration was less than one-half the average cost of defending lawsuits that had previously been litigated. This difference occurs, primarily, because the costs associated with pre-trial discovery—depositions, interrogatories, various pre-trial motions, etc.—do not accompany the arbitration process or occur only on a more limited basis.

From an employee's perspective, too, ADR saves money, because it takes less time. Moreover, these reduced expenditures may make it easier for employees to obtain legal representation, and so to pursue their claims, since a plaintiff attorney will not need to commit nearly the amount of time and resources that would be required if the employee/plaintiff had litigated the claim.

2. Resolves disputes more quickly.

Once an arbitrator is selected, a hearing can be quickly scheduled and a decision rendered shortly thereafter. In many cases, a decision can be rendered in three to six months after the parties select the arbitrator to hear the dispute. This compares to a year or more (often much more) to bring employment-related matters to trial. Thus, employees can resolve their claims expeditiously, enabling them to put such cases behind them and get on with their careers, without the aggravations associated with prolonged litigation.

3. Takes away plaintiff lawyers' leverage in negotiations.

Plaintiff lawyers have less power during ADR because defending an arbitrated claim costs much less than defending a litigated one and because the prospect of a runaway financial award lessens with an arbitrator as opposed to a jury.

4. Avoids the uncertainty associated with jury trials.

Many, if not most, of today's employment-related lawsuits qualify for trial by jury. Because of the "sympathy factor" and the uncertainty associated with jury trials, most employers hesitate to have their cases go to a jury. The substantial jury verdicts, with often totally outlandish punitive damage awards, provide a sound basis for this reluctance on the part of employers.

5. Avoids the publicity and media attention that frequently accompany litigation.

The parties can, and frequently do, agree to keep workplace ADR proceedings confidential. This privacy benefits both the employer and the employee, by preventing each from airing the other's "dirty linen" in public. Employers naturally worry about public perception of the company. But employees, too, worry. A terminated employee who has undergone ADR can pursue other career opportunities without the threat that negative publicity, arising from a dispute with a previous employer, will be "aired publicly," thus deterring prospective employers from considering the employee's candidacy.

B. Disadvantages

With workplace ADR's advantages, though, come disadvantages—many of the potential weaknesses being inseparable from ADR's strengths. Even a well-conceived and well-executed workplace ADR program involves risks, though the advantages usually outweigh them. Therefore, both when workplace ADR succeeds and when it fails, it possibly:

1. Increases contested employment-related issues.

By making ADR readily available, an employer can appear to invite employment-related claims. However, most employers who have adopted ADR programs have not experienced an increase in workplace complaints that require third-party resolution.

2. Limits the parties' right to judicial review.

Judicial proceedings and decisions at the trial level are subject to challenge on appeal. Rulings the trial judge makes on discovery issues, admissibility, motions, jury instructions, etc. can be overturned if a higher court deter-

mines that the judge has ruled incorrectly. Arbitration, on the other hand, circumscribes review of an arbitrator's decision-making. On appeal, the question is not whether the arbitrator's decision was right or wrong, but whether the arbitrator had the authority to make the decision rendered.

Note, however, one exception. Most courts will subject an arbitrator's legal interpretation of public laws to limited judicial review. That is, courts will ask whether the award reflects a manifest disregard for the law. If it did not, the arbitrator's decision will stand.

3. Makes employees fear that employers have stolen something from them.

Certain employees may believe that they are forfeiting their statutory right to litigate their claims. This is true. However, it can be creditably argued that the positive aspects of arbitration counterbalance the loss. As indicated above, the process can serve employees' best interests by resolving their claim without the cost, delay, aggravations and publicity attendant litigation.

4. Creates uncertainty over an agreement's enforceability and the possibility of being forced to litigate this issue.

Although the overwhelming number of courts that have ruled on mandatory arbitration agreements have upheld their enforceability, dissenting court decisions exist, particularly in California and the Ninth Circuit. Questions will remain until the U.S. Supreme Court resolves all issues regarding workplace ADR or Congress passes legislation on this subject. Employers may therefore still need to litigate the issue of whether a mandatory ADR agreement is enforceable.

Thus, paradoxically, even if such employers ultimately stay out of court with regard to the substantive employment claim, the effort to stay out of court will itself have dragged them into court over the enforceability issue. In the pre-*Waffle House* case of *Borg-Warner Protective Services Corp. v. EEOC*, for example, the U.S. Court of Appeals for the District of Columbia refused to enjoin the EEOC from issuing policy statements that all arbitration agreements violated Title VII, because the employer, having suffered no legally cognizable injury, lacked standing.[41] Similarly, in the post-*Waffle House* case of *Rivera v. Solomon Smith Barney Inc.*, the U.S. District Court for the Southern District of New York dismissed a former employee's suit for a declaratory judgment on whether the employer's ADR agreement would apply to a hypothetical civil rights claim, because no "actual controversy" existed.[42] In both cases, uncertainty frustrated employers and employees alike, because they could not avoid preliminary litigation aimed at answering merely whether one could litigate a future claim, and even after the initial litigation ended, neither side knew whether future litigation was possible.

Ultimately, neither party can avoid uncertainty about some issues, given the inevitable imprecision of contract language. That is, court cases have sometimes been necessary simply to determine what a given mandatory ADR agreement means, with regard to its own scope. In *International Brotherhood of Electrical Workers v. Balmoral Racing Club, Inc.,* for example, the U.S. Court of Appeals for the Seventh Circuit held that an employer must arbitrate with a union a dispute involving workers employed only briefly, because the union's collective bargaining agreement with the employer made unreviewable the union president's formal determination that the agreement covered those workers.[43] On the other hand, in *Birch v. Pepsi Bottling Group Inc.,* the U.S. District Court for the District of Maryland held that an employee's ADA claim did not fall within the scope of her collectively-bargained-for agreement to arbitrate all employment-related disputes, because the agreement did not clearly and unmistakably refer to the ADA.[44] Again, the mandatory ADR agreement incited litigation, instead of quashing it.

V. Conclusion

On the whole, resolving employment-related claims and other workplace disputes through the arbitration process makes good sense. Those groups opposing mandatory arbitration of employment disputes argue that the system should be an option and not a required condition of employment. Why? So long as the system adopted is fair, impartial, open to judicial review, and able to provide the same relief as would the judicial process, no good reason exists for barring mandatory arbitration and thereby clogging our court system with proliferating workplace claims. The number of discrimination cases filed annually in federal courts between 1990 and 1999 increased from 8,413 to 22,412. However, this trend may be reversing itself, according to the annual report of the Administrative Office of the United States. Perhaps the adoption of ADR agreements by employers is reducing the judicial glut of employment cases, most particularly discrimination cases.

Mandatory arbitration of employment disputes has worked well in the union setting, where almost every collective bargaining agreement includes a grievance provision culminating in arbitration. This process can be equally effective in resolving disputes in the non-union setting, provided the safeguards referred to earlier are in place.

The objective of Title VII and similar civil rights statutes is to eliminate discrimination in the workplace. There is no reason to believe that employers who have mandatory arbitration agreements with their employees are more likely consciously to discriminate against their employees than those employers who do not. Nor is there any reason to believe that, when discrimination does occur, the arbitration process cannot adequately remedy it. Indeed, given the relative speed of arbitration, any remedy that an arbitrator imposes will probably cause a more worthwhile effect than one that the courts provide only after long years of litigation.

In summary, therefore, a legally sufficient ADR agreement benefits all concerned parties: employees, employers and the courts whose dockets will lighten as more companies adopt mandatory mediation/arbitration procedures. The only parties left complaining are plaintiff trial

lawyers, civil rights groups and the EEOC. The first group stands to lose the leverage that a threat of lengthy, expensive litigation gives it in settlement negotiations. The latter groups fear losing the power to portray themselves as exclusive vindicators of employee rights. These fears, however, dwindle in view of the Supreme Court's *Waffle House* decision, whereby the EEOC retains the right to seek individual relief in certain cases and to pursue cutting-edge discrimination law issues.

In short, in most instances, ADR workplace agreements present a win-win situation for employees and employers alike, without depriving the EEOC of its statutory right to seek relief, create new law and protect employee interests in appropriate cases.

* Francis "Tom" Coleman is a partner in the Washington, D.C. office of the Williams Mullen law firm, representing management in labor and employment matters. Mr. Coleman is a member of the Federalist Society's Labor and Employment Practice Group.

Footnotes

[1] 388 U.S. 395, 404 (1967).

[2] *See United Steelworkers v. American Mfg. Co.,* 363 U.S. 564 (1960) (defining standard that federal court must apply when determining whether to submit grievance to arbitration); *United Steelworkers v. Warrior & Gulf Navigation Co.,* 363 U.S. 574 (1960) (same); *United Steelworkers v. Enterprise Wheel & Car Corp.,* 363 U.S. 593 (1960) (defining standard that court must apply when winning party seeks to enforce arbitral award); *see also Textile Workers Union v. Lincoln Mills,* 353 U.S. 448 (1957) (establishing enforceability of collective bargaining agreement in federal courts).

[3] *See Circuit City Stores v. Adams*, 532 U.S. 105, 123 (2001).

[4] *See id.,* 532 U.S. at 119; *interpreting* 9 U.S.C. § 1 (1994).

[5] *See* H.R. 815 (referred on March 9, 2001, to the House Subcommittee on Commercial and Administrative Law).

[6] *See* S. 163, "Civil Rights Procedures Protection Act of 2001" (referred that day to the Senate Committee on Health, Education, Labor and Pensions).

[7] *See* H.R. 1489 (referred that day to the House Committee on Education in the Workforce and the House Committee on the Judiciary).

[8] *See* H.R. 2282, "Preservation of Civil Rights Protections Act of 2002" (referred on September 18, 2001, to the House Subcommittee on Employer-Employee Relations).

[9] *See* S. 2435 (referred that day to the Senate Committee on Health, Education, Labor and Pensions).

[10] *See* S. 3026, "Arbitration Fairness Act of 2002" (referred that day to the Senate Committee on the Judiciary).

[11] *See EEOC v. Waffle House, Inc.*, 534 U.S. 279 (2002).

[12] *Id.,* 534 U.S. at 291.

[13] *See id.,* 534 U.S. 294.

[14] *See* 534 U.S. at 297-98.

[15] *See Circuit City Stores, Inc. v. Adams*, 279 F.3d 889, 893-94 (9th Cir. Feb. 4, 2002), *cert. denied*, 122 S.Ct. 2329 (June 3, 2002).

[16] *See EEOC v. Luce*, 303 F.3d 994, 1004 (9th Cir. Sept. 3, 2002).

[17] *See Adkins v. Labor Ready, Inc.,* 303 F.3d 496, 506 (4th Cir. August 30, 2002).

[18] *See Tinder v. Pinkerton Security*, 305 F.3d 728, 736 (7th Cir. Sept. 17, 2002).

[19] *See Brown v. Illinois Central Railroad Co.,* 254 F.3d 654, 660-61 (7th Cir. June 20, 2001), *cert. denied,* 122 S.Ct. 616 (November 11, 2001).

[20] *See Weeks v. Harden Manufacturing Corp.,* 291 F.3d 1307, 1312-16 (11th Cir. May 22, 2002).

[21] *See Martindale v. Sandvik Inc.*, 800 A.2d 872, 881 (N.J. July 17, 2002).

[22] *See In re Halliburton Co.*, 80 S.W.3d 566, 572-73 (Tex. May 30, 2002).

[23] *See Barnica v. Kenai Peninsula Borough School District*, 46 P.3d 974, 977 (Alaska May 3, 2002).

[24] *See Garfinkel v. Morristown Obstetrics and Gynecology Associates,* 773 A.2d 665, 672 (N.J. June 13, 2001).

[25] *See Dumais v. American Golf Corp.*, 299 F.3d 1216, 1219 (10th Cir. Aug. 15, 2002).

[26] *Cole v. Burns Int'l Security Services*, 105 F. 3d. 1465, 1482 (D.C. Cir. 1997).

[27] *See* Revised Uniform Arbitration Act (www.law.upenn.edu/bll/ulc/ul/_frame.htm).

[28] *See Bailey v. Ameriquest Mortgage Co.,* No CIV. 01-545 (JRT/FLN), 2002 WL 1835642 at *1 (D. Minn. Aug. 5, 2002).

[29] *See id.*

[30] *See Blair v. Scott Specialty Gases*, 283 F.3d 595, 603-04 (3d Cir. March 13, 2002).

[31] *See id.,* 283 F.3d at 604-10.

[32] *See Cole v. Burns Int'l Security Services*, 105 F. 3d. 1465, 1482 (D.C. Cir. 1997).

[33] *See Bond v. Twin Cities Carpenters Pension Fund*, 307 F.3d 704, 706 (8th Cir. Oct. 8, 2002).

[34] *See Ferguson v. Countrywide Credit Industries,* 298 F.3d 778, 787 (9th Cir. July 23, 2002).

[35] *See Gambardella v. Pentec, Inc.,* 218 F.Supp.2d 237, 241-42 (D. Conn. July 11, 2002).

[36] *See id.,* 218 F.Supp.2d at 247.

[37] *See Perez v. Globe Airport Security Service, Inc.,* 253 F.3d 1280, 1285-87 (11th Cir. June 12, 2001).

[38] *See id.,* 294 F.3d 1275, 1275 (11th Cir. March 22, 2002).

[39] *See Green Tree Financial Corp.- Ala v. Randolph*, 531 U.S. 79, 92 (Dec. 11, 2000).

[40] *See Goodman v. ESPE Am. Inc*., No. 00-CV-862, 2001 WL 64749 at *4 (E.D. Pa. Jan. 19, 2001).

[41] *See Borg-Warner Protective Services Corp. v. EEOC*, 245 F.3d 831, 836-38 (D.C. Cir. April 17, 2001).

[42] *See Rivera v. Solomon Smith Barney Inc.*, No. 01 Civ. 9282 (RWS), 2002 WL 31106418 at *2 (S.D.N.Y. Sept. 20, 2002).

[43] *See International Brotherhood of Electrical Workers v. Balmoral Racing Club, Inc.,* 293 F.3d 402, 406-08 (7th Cir. June 13, 2002).

[44] *See Birch v. Pepsi Bottling Group Inc.,* 207 F.Supp.2d 376, 383-85 (D. Md. May 2, 2002).

LITIGATION

WAGING WAR AGAINST BINDING ARBITRATION: WILL TRIAL LAWYERS WIN THE BATTLE?

*BY ERIKA BIRG**

INTRODUCTION

We all likely consume goods or services subject to standard contracts with vendors, contracts that we often do not even bother to read before we sign. Only when a problem with the vendor – or the provided goods or services – arises do we even pull the contract out (if we can find it) to peruse the promises and obligations therein. At that point, many find out for the first time that their expectations are not coterminous with the promises contained in the contract. Others will find that the vendor is in fact not living up to its obligations. In that situation, the solution is often easy – bring the problem to the attention of the vendor and reach a mutually acceptable solution. Yet, sometimes that fails to work. What then?

In a room full of lawyers, a likely answer is "sue," and depending on the lawyers, the claims, and the potential defendant, some might say, "bring a class action." And, bringing class actions is what trial lawyers are doing with astounding frequency. Partly in a defensive response to the onslaught of class action cases, businesses began inserting arbitration clauses in their consumer contracts to avoid the costs and risks associated with litigation, particularly, class actions.

Consumers (or more accurately, trial lawyers) are waging war against business to void these arbitration agreements.[1] Plaintiff's lawyers (now known euphemistically as "trial lawyers") have gone so far as to say that the use of a binding arbitration system is nothing other than an attack on America's civil jury system.[2] With sights set on large fees, the trial lawyers hope to avoid the arbitration process and to pull businesses into court to defend against claims, preferably in a class action, or at a minimum have the arbitration proceed as a class action.[3]

There are generally one of two types of binding arbitration agreements at issue: those that prohibit all class action mechanisms or those that are silent regarding whether class action procedures may be imposed on arbitration. As to the first, trial lawyers seek to invalidate agreements that specifically prohibit class-wide arbitration on the grounds that they are unconscionable.[4] In declaring the class-wide arbitration bar unconscionable, courts have not been striking down the entire arbitration clause – just the part that requires the arbitration to proceed on an individual rather than class-wide basis. The courts have rewritten agreements to allow arbitration but to impose class action procedures. This is the same result many courts have reached with agreements that are silent as to whether class claims may be brought.

MIXED RESULTS

Under the Federal Arbitration Act, 9 U.S.C. 1 *et seq.* ("FAA"),[5] arbitration agreements are to be enforced, according to their terms, "save upon such grounds as exist at law or in equity for the revocation of any contract."[6] The arguments made in support of imposing class action mechanisms on otherwise silent arbitration clauses and in negating agreements that prohibit class actions overlap. In particular, courts say that the policies underlying class actions must trump those underlying arbitration to ensure an even playing field for dispute resolution between consumers and business.[7]

Primarily, courts conclude that if a claim is small in amount or the allegedly aggrieved party is impecunious, there is no incentive for the aggrieved to bring an action and/or no economic incentive for an attorney to assist.[8] "When the class action prohibition operates entirely to deprive claimants of a viable forum in either litigation or arbitration for their claims, that prohibition alone ought to be sufficient to render the clause unconscionable."[9] In other words "the resolution of individual claims through arbitration is no adequate substitute for the resolution of group claims in a class action."[10]

Federal and state courts, however, generally are split on their approach to the question when the agreement is silent. Federal courts, relying on the express provisions of the FAA, almost exclusively have found that silence in the arbitration agreement does not equal consent to class arbitration.[11] On the flip side, many state courts will allow class action procedures to be imposed on silent agreements and also will strike a class action prohibition contained in an otherwise valid arbitration clause.[12]

The United States Court of Appeals for the Seventh Circuit's decision in *Champ v. Siegel Trading Co.*, 55 F.3d 269 (7th Cir. 1995), is the leading federal case for the proposition that federal courts lack authority to order class action arbitration where the agreement does not provide for class claims to be brought. The court relied primarily on previous cases finding that federal courts lack authority to order consolidated arbitration if the agreement did not specifically provide for it.[13] Invocation of the consolidated and class action procedures were based, in part, on Federal Rule of Civil Procedure 81(a)(3), which states generally that the Federal Rules of Civil Procedure, including Rules 23 and 42, apply to "proceedings under Title 9, U.S.C., relating to arbitration . . . to the extent that matters of procedure are not provided for in those statutes." The Seventh Circuit rejected an interpretation of Rule 81(a)(3) that would condone consolidation of proceedings or class-wide proceedings, stating

> [f]irst of all, Rule 81(a)(3) says that the Federal Rules will fill in only those procedural gaps left open by the FAA. But as explained above, section 4 of the FAA requires that we enforce an arbitration agreement according to its terms. Such terms conceivably could consist of consolidated or even class arbitration. The parties here did not include in their agreement an express term providing for class arbitration. Thus, one could say that through the proper application of 9 U.S.C. § 4 the FAA has already provided the type of procedure to be followed in this case, namely, non-class-action arbitration.

Id. at 276.[14] Moreover, and correctly so, the court ruled that Rule 81(a)(3) applied to only judicial proceedings under Title 9, not the underlying arbitration.[15]

Finally, the court rejected the argument that "various inefficiencies and inequities will result from denying [plaintiffs] the opportunity to pursue arbitration on a class basis against these defendants."[16] Recognizing that individual arbitration may not be as efficient, the court nevertheless turned back to the agreement and to the Supreme Court's pronouncement that "we must rigorously enforce the parties' agreement as they wrote it, 'even if the result is "piece-meal" litigation'."[17]

On the state court side, in *Keating v. Superior Court*, 31 Cal. 3d 584 (1982), the California Supreme Court concluded that if "an arbitration clause may be used to insulate the drafter of an adhesive contract from any form of a class proceeding, effectively foreclosing many individual claims, it may well be oppressive and may defeat the expectations of the nondrafting party."[18] Even the lone dissent on the class action issue concluded that

> where an arbitration clause in an adhesion contract would allow the stronger party to evade responsibility for its acts, such a clause may, under those facts, be found oppressive and the clause invalidated. In instances where an arbitration clause would effectively deny relief to the weaker party in an adhesion contract, relief under settled principles of law would potentially be available.

Keating, 31 Cal. 3d at 626 (Richardson, J., dissenting in part).[19]

The *Keating* court also looked to authorities generally allowing consolidated arbitration under federal and state rules.[20] Reasoning that because consolidated arbitration proceedings could force a party into an arbitration

> with a party with whom he has no agreement, before an arbitrator he had no voice in selecting and by a procedure he did not agree to . . . . *an order for class wide arbitration in an adhesion context would call for considerably less intrusion upon the contractual aspects of the relationship.*

Id. at 612 (emphasis added). Rejecting the Supreme Court's admonition that courts are to "rigorously enforce agreements to arbitrate,"[21] the court remarked, "[i]f the alternative in a case of this sort is to force hundreds of individual[s] . . . each to litigate its cause with [defendant] in a separate arbitral forum, then the prospect of class-wide arbitration, for all of its difficulties, may offer a better, more efficient and fairer solution."[22]

The concern, expressed by the dissent in *Keating* and raised many times over, is the high cost of arbitration, with some filing fees starting at nearly $2,000 plus the expense of daily arbitrator fees.[23] Where the arbitration clauses do not provide that the business will pay the costs of arbitration, courts believe consumers will not initiate arbitration. "[I]t is apparent that in a number of situations, large arbitration costs will preclude class members from effectively vindicating their legal rights."[24]

THE ISSUE REACHES THE SUPREME COURT

While the issue has been percolating over the last two decades, it has risen to the Supreme Court several times. In *Southland Corp. v. Keating*, 465 U.S. 1 (1984),[25] the Supreme Court declined to address the issue because the petitioner had not argued below that "if state law required class-action procedures, it would conflict with the federal Act and thus violate the Supremacy Clause."[26]

Several years later, in *Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20 (1991), the Supreme Court avoided the issue rather than addressing it directly:

> It is also argued that arbitration procedures cannot adequately further the purposes of the ADEA, because they do not provide for . . . class actions. . . . The NYSE rules also provide for collective proceedings. *Id.* . . . But "even if the arbitration could not go forward as a class action or class relief could not be granted by the arbitrator, the fact that the [ADEA] provides for the possibility of bringing a collective action does not mean that individual attempts at conciliation were intended to be barred." *Nicholson v. CPC Int'l Inc.*, 877 F.2d 221, 241 (CA3 1989) (Becker, J., dissenting). Finally, it should be remembered that arbitration agreements will not preclude the EEOC from bringing actions seeking class-wide and equitable relief.

Id. at 32.

And, as recently as December 2000, the Supreme Court was presented with the issue once again in *Green Tree Fin. Corp.–AL v. Randolph*, 531 U.S. 79 (2000) ("*Green Tree I*"), where respondent argued that the arbitration agreement was unenforceable, in part,[27] because it denied her the ability to prosecute her claims and the claims of others as a class action, which would have been allowed by statute (Truth In Lending Act) had she been able to proceed in court.[28] Reciting the Supreme Court pronouncements regarding the purposes underlying the class action mechanism,[29] respondent contended that "*arbitration agreements should not be enforced absent express provision for class actions*."[30] Yet, the Supreme Court did not rule on the issue because it was not raised below.[31]

Nevertheless, the issue appears again in a case in which the Supreme Court recently granted certiorari – *Green Tree Fin. Inc. v. Bazzle*, 123 S. Ct. 817 (cert. granted, Jan. 10, 2003) ("*Green Tree II*"). In this case, the Court will

review the South Carolina Supreme Court's decision[32] that an arbitration agreement governed by the FAA allowed arbitration of class claims, despite the agreement's apparent silence.[33] The court rejected the *Champ* approach – under which the FAA weighed the policy of enforcing arbitration agreements as weightier than potential efficiencies that might be had in a class action – and adopted the *Keating* approach – which favored efficiency over the strict enforcement of the agreement as written. The South Carolina Supreme Court spent little time discussing *Champ*, dismissing it out of hand because it "failed to discuss whether the arbitration agreement was one of adhesion or was truly *negotiated* by the parties, and failed to discuss the differences between consolidation and class-action on a practical level."[34] The court remarked that "'[a]s a matter of pure contract interpretation it is striking, and rather odd, that so many courts have interpreted silence in arbitration agreements to foreclose rather than permit arbitral class actions.'"[35]

The South Carolina Supreme Court instead adopted the reasoning of *Keating* and a later California Court of Appeals case, *Blue Cross v. Superior Court.*, 67 Cal. App. 4th 42 (Cal. App. 1998), *cert. denied*, 527 U.S. 1003 (1999), which held that Section 4 of the FAA did not preempt contrary state law. The South Carolina Supreme Court thus concluded that a court may, in its discretion, order class-wide arbitration where the agreement is silent "if it would serve efficiency and equity, and would not result in prejudice." [36]

Thus, in *Green Tree II*, the Supreme Court will directly confront the question whether the FAA "prohibits class action procedures from being superimposed onto an arbitration agreement that does not provide for class action arbitration."[37] In other words, do the concerns of "efficiency" and "equity" trump the policies embodied in Sections 2 and 4 of the FAA to force parties to arbitrate in accordance with the terms of their agreement?

THE POLICIES SUPPORTING CLASS ACTIONS SHOULD GIVE WAY TO THOSE FAVORING ARBITRATION

Class action mechanisms are creatures of procedure[38] just as arbitration agreements are creatures of contract. Rights to bring class action claims are not substantive or inalienable rights, and, accordingly should not overcome the parties' agreement. If the parties either failed to provide for a particular mechanism in the initial agreement or did not consent to the procedure later, then it should not be used.[39]

By favoring "efficiency" over the parties' agreement, the court sweeps aside the parties' legitimate expectations. It is these expectations that Congress in part sought to protect in enacting the FAA. Moreover, in allowing "efficiency" to trump the parties' agreement, courts reveal hostility to arbitration (on the parties' terms) because it lacks the procedural comforts of litigation. That hostility is exactly the type of problem the FAA was intended to overcome.[40] Hence, mere preference for efficiency should not allow courts to write rules for arbitration or to rewrite arbitration agreements. In contravention of the clear language of 9 U.S.C. § 4, courts are not revoking the contract but rewriting the agreement. In sum, concluding that class action procedures may be superimposed on silent arbitration agreements or deciding that a clause barring a class action is unenforceable "cannot be reconciled with this Court's decisions which make clear that concerns regarding efficiency and economy are subsidiary to enforcement of the parties' agreement according to its terms,"[41] and cannot be reconciled with the FAA.

THE BATTLE MAY NOT BE OVER

Notwithstanding the issue presented in *Green Tree II*, trial lawyers, who are providing their peers and consumers with the tools to negate arbitration clauses,[42] may not rest until all arbitration clauses in consumer contracts – not just no-class-action clauses – are unenforceable.[43] State courts favoring class actions may assist them in that goal. Finding themselves without the "authority" to order class-wide arbitration, the courts simply may order class action litigation, reasoning that if class actions are not permitted in arbitration then the entire arbitration clause is unconscionable. That will leave the parties in court, with the full panoply of procedural mechanisms available to trial lawyers, including class actions.

Although the unconscionability issue is not presented directly to the Supreme Court in *Green Tree II*, the Court may be able to take significant strides to restoring the enforceability of arbitration clauses in consumer agreements. In particular, by reinforcing that the policies favoring arbitration should outweigh those favoring class actions, the Court may be able to reduce the chance of the trial lawyers' success in this on-going battle.

* Erika Birg is attorney practicing in Washington, D.C. The views expressed herein are the author's alone.

Footnotes

[1] Jere Locke Beasley, *The Evils of Binding Arbitration in Consumer Contracts*, at 2, 7 (Nov. 2002), http://www.beasleyallen.com/articles/Evils%20of%20Binding%20Arbitration.pdf (last visited Jan. 29, 2003) ("[C]onsumers and small business owners are in a battle that must be won."); *see also* Jere Locke Beasley, *Arbitration: Public Enemy Number One* (undated), http://www.beasleyallen.com/articles/Arbitration-publicenemy1-ATLA-01-00.pdf (last visited Jan. 30, 2003).

[2] Beasley, *supra note 1*, at 9 ("It is difficult to see how the United States Supreme Court can construe an Act of Congress such as the FAA and apply it beyond its original intent in such a way as to prevent citizens of the United States and the several states from exercising their Constitutional right to litigate in a court of law before a jury. In order to do so, the Court must ignore the Seventh and Tenth Amendments to the U.S. Constitution as well as the state constitutional guarantees of the right to trial by jury."). The trial lawyers also are pushing their agenda in Congress and returning large fee awards to elect politicians and judges opposed to tort reform. *See* Stephen J. Ware, *Arbitration Under Assault: Trial Lawyers Lead the Charge*, Policy Analysis No. 433, , at 6-8 (Cato Institute Apr. 18, 2002); Stephen Moore, *Cause for Trial Bar Celebration*, http://www.cato.org/dailys/12-04-99. html (last visited Feb. 7, 2003).

[3] *See* http://www.milliondollaradvocates.com (last visited Feb. 7, 2003).

[4] Courts assess unconscionability in a two-step analysis: (1) is the manner in which the agreement was obtained unfair (procedural unconscionability), and (2) are the contract terms so one-sided as to "shock the conscience" (substantive unconscionability). *See generally Szetela v. Discover Bank*, 118 Cal. 2d 862, 867 (Ct. App. Div. 3

2002) ("Procedural unconscionability focuses on the manner in which the disputed clause is presented to the party in the weaker bargaining position. . . . Substantive unconscionability addresses the fairness of the term in dispute."); F. Paul Bland, Jr., *Is That Arbitration Clause Unconscionable? PROVE IT!* , The Consumer Advocate No. 4 (Jul.-Aug. 2002), http://www.tlpj.org/News_PDF/fall-02/07-01-02-consumer.advocate.pdf (last visited Jan. 30, 2003) (hereinafter, "Bland"); Mark E. Budnitz, *Developments in Consumer Arbitration Case Law: 1997 – August 2000* (2000), http://law.gsu.edu/mbudnitz/arbsumryjune01.pdf (last visited Jan. 30, 2003) (cataloguing cases).

[5] Title 9, Section 2, provides that pre-dispute arbitration agreements are enforceable according to their terms.

A written provision in any . . . contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, . . . shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Id.

[6] *Id.*

[7] *See Szetela*, 118 Cal. Rptr. 2d at 868 (finding clause unconscionable because it would allow the business to avoid many smaller claims – "a 'get out of jail free' card" – "while compromising important consumer rights"); *Mendez v. Palm Harbor Homes, Inc.* 45 P.3d 594, 111 Wash. App. 446 (2002) (concluding that if class action mechanism is only way for a plaintiff to attempt to vindicate rights, then public policy favoring arbitration "must defer to the overriding principle of access to justice"); *see also Ting v. AT&T Corp.*, 182 F. Supp. 2d 902, 930 (N.D. Cal. 2002) ("Case law and public policy embrace the importance of class actions as a vital instrumentality of consumer protection.").

[8] Jean R. Sternlight, *Should an Arbitration Provision Trump the Class Action? No: Permitting companies to skirt class actions through mandatory arbitration would be dangerous and unwise*, ABA Dispute Resolution Mag. at 13 (Spring 2002) (hereinafter, "Sternlight") ("Drafters of these clauses know that if they can eliminate class actions, they can often eliminate claims exposure altogether because individual claims will not be brought.").

[9] *Id*.

[10] *Id.*

[11] *See Champ v. Siegel Trading Co.*, 55 F.3d 269, 275 (7th Cir. 1995) (citing cases); *see also Johnson v. West Suburban Bank*, 225 F.3d 366, 377 N.4 (3rd Cir. 2000); *Howard v. KPMG*, 977 F. Supp. 654, 665, n.7 (S.D.N.Y. 1997), *aff'd* 173 F.3d 844 (2d Cir. 1999); *but see New England Energy Inc. v. Keystone Shipping Co.*, 855 F.2d 1 (1st Cir. 1988).

[12] *See Keating v. Superior Court.*, 645 P.2d 1192, 1208-10 (1982), *rev'd on other grounds sub nom. Southland Corp. v. Keating*, 465 U.S. 1 (1984); *see also Blue Cross of Cal. v. Superior Court.*, 67 Cal. App. 4th 42, 62-66 (1998); *Dickler v. Shearson Lehman Hutton, Inc.*, 596 A.2d 860 (Pa. Super. Ct. 1991), *appeal denied*, 616 A.2d 984 (Pa. 1992); *but see Discover Bank v. Superior Court*, 105 Cal. App. 4th 326 (2003); *Stein v. Geonerco, Inc.*, 17 P.3d 1266, 1271 (Wash. Ct. App. 2001); *Med Center Cars, Inc. v. Smith*, 727 So.2d 9 (Ala. 1998).

[13] *Champ*, 55 F.3d at 274-75 (citing cases).

[14] In accord with 9 U.S.C. § 2, under Section 4, a party may move in federal court "for an order directing that arbitration proceed ***in a manner provided for in such agreement.***" 9 U.S.C. § 4 (emphasis added).

[15] *Champ*, 55 F.3d at 276.

[16] *Id.* at 277.

[17] *Id.* (quoting *Dean Witter Reynolds, Inc. v. Byrd*, 470 U.S. 213, 221 (1985)).

[18] *Keating*, 31 Cal. 3d at 610.

[19] *See also Mendez*, 45 P.3d at 607, 111 Wash. App. at 469 (contending that the "primary public policy issue at stake [is] high arbitration costs precluding the consumers access to a forum where he or she can vindicate his or her claim").

[20] *Keating*, 31 Cal. 3d at 610-11.

[21] *Dean Witter Reynolds v. Byrd*, 470 U.S. 213, 221 (1985).

[22] *Keating, 31 Cal. 3d.* at 613.

[23] *See Mendez*, 45 P.3d at 603-05, 111 Wash. App. at 461-65.

[24] *Ting*, 182 F.Supp.2d at 934. *Cf. Morrison v. Circuit City Stores, Inc.*, Case Nos. 99-4099, 99-5897, 2003 WL 193410 (6th Cir. Jan. 30, 2003) (holding cost-splitting provisions in employment arbitration clause unenforceable).

[25] This case arose out of the same litigation as *Keating v. Superior Court*.

[26] *Southland Corp.*, 465 U.S. at 8.

[27] The primary issue in the case was whether an agreement that was silent as to the allocation of costs of arbitration was enforceable. While the Court began by indicating that "[i]t may well be that the existence of large arbitration costs could preclude a litigant . . . from effectively vindicating her federal statutory rights in the arbitral forum" the Court found that "silence . . . alone is plainly insufficient to render [an arbitration agreement] unenforceable." 531 U.S. at 91. The Court reasoned that "a party seeking to invalidate an arbitration agreement on the ground that arbitration would be prohibitively expensive bears the burden of showing the likelihood of incurring such costs." *Id.* at 92. Because respondent did not show how she actually would be subject to unbearable costs, such that mandatory arbitration would prevent her from having a forum in which to resolve the disputes, the Supreme Court did not find the provision unconscionable. The Court concluded that because she did not carry that burden, a finding that the clause was unconscionable "would undermine the 'liberal federal policy favoring arbitration agreements.'" *Id.* at 91 (quoting *Moses H. Cone Mem. Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 24 (1983)).

[28] *Green Tree I*, Br. of Resp. at 39 (filed July 24, 2000).

[29] *See Amchem Products, Inc. v. Windsor*, 512 U.S. 591, 617 (1997) ("The policy at the very core of the class action is to overcome the problem that small recoveries do not provide the incentive for any individual to bring a solo action prosecuting his or her rights."); *Phillips Petrol. Co. v. Shutts*, 472 U.S. 797, 809 (1985) ("[M]ost of the plaintiffs would have no realistic day in court if a class action were not available."); *Eisen v. Carlisle & Jacquelin*, 417 U.S. 156, 161 (1974) ("Economic reality dictates that petitioner's suit proceed as a class action or not at all.").

[30] *Green Tree I*, Br. of Resp. at 48 (emphasis added).

[31] *Green Tree I*, 531 U.S. at 92 n. 7.

[32] *Green Tree Fin.Corp. v. Bazzle*, 569 S.E.2d 349, 351 S.C. 244 (2002).

[33] Whether the agreement between Green Tree and Bazzle is silent on the point of class action procedures was disputed at the trial court level. Petitioner Green Tree has continued to argue that "[b]y limiting the arbitrator's authority to address claims or relationships that result from '*this* Contract,' the agreement precludes consolidated or class-wide arbitration of disputes involving *other* contracts." *Green Tree II*, Pet. for Writ of Cert. at 6-7. That argument, however, fell on deaf ears, and the trial court ordered Green Tree to arbitrate the claims as class claims. *Id.* at 7.

[34] *Bazzle*, 569 S.E.2d at 356, 351 S.C. at 249.

[35] *Id.* at 360, 351 S.C. at 265 (quoting Jean R. Sternlight, *As Mandatory Binding Arbitration Meets the Class Action, Will the Class Action Survive?*, 42 Wm. & Mary L. Rev. 1, 83 (Oct. 2000)).

[36] *Id.* at 361, 351 S.C. at 266.

[37] *Green Tree II*, Pet. For Writ of Cert., at i, (filed Oct. 23, 2002) ("Question Presented").

[38] *See* Fed. R. Civ. P. 23. *But see Discover Bank v. Superior Court*, 105 Cal. App. 4th 326, —, 129 Cal. Rptr. 2d 393, 409-10 (2003) (concluding that the issue of whether a class action waiver was enforceable was a matter of substance rather than procedure because it exposed defendant to an increased "scope of potential liability and damages . . . without the ability to seek judicial review of the merits of the arbitrator's decision").

[39] Consumers are not without resources to protect themselves. In an interesting twist, the Alabama Supreme Court recently found that a consumer's addendum to a vendor form contract was effective to eliminate a binding arbitration clause. Terry Carter, *Eating Away at Arbitration*, ABA Journal Ereport (Jan. 10, 2003). The addendum stated in pertinent part:

Cook's [Pest Control] agrees that any prior amendment to the Customer Agreement shall be subject to written consent before arbitration is required. In the event that a dispute arises between Cook's [Pest

Control] and Customer, Cook's [Pest Control] agrees to propose arbitration is [sic] so desired, estimate the cost thereof, and describe the process (venue, selection of arbitrator, etc.). Notwithstanding prior amendments, nothing herein shall limit Customer's right to seek court enforcement (including injunctive or class relief in appropriate cases) nor shall anything herein abrogate Customer's right to trial by jury. Arbitration shall not be required for any prior or future dealings between Cook's [Pest Control] and Customer.

See Cook's Pest Control v. Rebar, No. 1010897, slip op. at 4, (Ala. Dec. 13, 2002). The customer included the addendum in the envelope with their regular payment. The vendor, Cook's Pest Control, cashed the check and then performed a termite inspection. As a result, Cook's had agreed to the new terms. Hence, the plaintiffs were not bound by the arbitration clause. *See Cook's Pest Control v. Rebar*, No. 1010897, slip op. (Ala. Dec. 13, 2002).

[40] *See Discover Bank*, 105 Cal. App. 4th at —, 129 Cal. Rptr. 2d at 410 ("Just as consumers are harmed by the enforcement of an unconscionable class action waiver, defendant companies may be able to prove they will be prejudiced if classwide arbitration is imposed where, even though the arbitration agreement is silent on the subject, the agreement has adopted arbitration rules, such as these of the [American Arbitration Association], that do not provide for classwide arbitration.").

[41] *Green Tree II*, Pet. for Writ of Cert. at 13; *see also Discover Bank*, 105 Cal. App. 4th at —, 129 Cal. Rptr. 2d at 409 (2003) (concluding that "it would defeat the purpose of the FAA, which was enacted primarily to ensure that arbitration agreements are enforced according to their terms . . . to strike the class action waiver from the agreement.").

[42] *See* Bland, *supra* note 5. Mr. Bland also is the co-author of a manual, *Consumer Arbitration Agreements: Enforceability and Other Options*, on how to prove that a "given arbitration clause is unconscionable in a given jurisdiction." *See id.; see also* Rhon Jones, *Defeating Arbitration Agreements Enclosed in the Delivery of Mail Order Products: What Protection Can the UCC Afford Consumers*, http://www.beasleyallen.com/articles/DefeatingArbitration.pdf (last visited Jan. 30, 2003).

[43] *See supra* note 2 (Beasley, *Arbitration: Public Enemy Number One*).

Preserving the Right to a Representative Jury

*By Keith T. Borman and Mark A. Behrens**

For over two centuries, the jury system has played an important and revered role in the American justice system.[1] As Alexis de Tocqueville observed long ago, "the practical intelligence and political good sense of the Americans are mainly attributable to the long use they have made of the jury."[2] Today, jury service is commonly accepted as one of the few obligations of good citizenship. National polls indicate that Americans hold the jury system in the highest regard — 78% percent of the public believe the jury system provides the most fair method of determining guilt or innocence; 69% consider juries to be the most important part of the justice system.[3]

In light of this strong public support, it is ironic that many Americans view jury service as a duty best discharged by others. In some urban jurisdictions, fewer than 10% percent of all summoned citizens show up in court.[4] Likewise, in some rural areas, sheriff's deputies have been forced to round up people shopping in the local Wal-Mart to fill the jury box.[5] According to one study, on average, about 20% of those summoned to jury duty each year in state courts do not respond.[6] While some of this can be attributed to out-of-date records and summonses that are mailed to the wrong address, many citizens simply ignore their civic obligation. Those who do arrive at the courthouse often avoid service through "occupational exemptions" that benefit certain professions or come presenting a purported "hardship excuse." All too often, potential jurors are successful in getting out of jury duty. This situation has made it difficult for many litigants to obtain a jury representing a true cross-section of the community.

The contradiction between strong public support for the jury system and the avoidance of jury service suggests that the jury system needs to be reformed to better serve Americans. It needs to become more "user friendly." This article discusses several of the core problems undermining the American petit jury system. It then discusses innovative model legislation, the "Jury Patriotism Act," recently developed by the American Legislative Exchange Council ("ALEC"), the nation's largest bipartisan membership association of state legislators. The Act would promote jury service in state courts by alleviating the burden and inconvenience placed on those called to serve while making it more difficult for people to escape from jury service without showing true hardship. Many of the changes suggested by the Act could also be accomplished by courts, so judges may want to consider them as well.

Citizens Avoid Jury Service

Occupational Exemptions

Some states unnecessarily limit the jury pool and automatically exempt potential jurors from service based on their occupation. Some of the more common exemptions include lawyers, doctors, public officials, and law enforcement officers. For some reason or another, these people are regarded as too important, socially, politically, or economically, to serve on a jury. The situation is not dissimilar to the policy of granting draft deferments to Vietnam-era students who had the means to afford college, while those who could not were called into service.

Other exemptions appear to be obsolete remnants of a time past. For example, Nevada continues to exempt various categories of "essential" railroad workers, such as firemen, brakemen, conductors, engineers, and switchmen, notwithstanding the fact that firemen are no longer employed on train crews and trains now operate with just two crew members (instead of six or more).[7] Wyoming apparently considers embalmers as too important for jury service.[8]

Regardless of the reason, "broad categorical exceptions not only reduce the inclusiveness and representativeness of a jury panel, but also place a disproportionate burden on those who are not exempt," most notably blue-collar workers, the retired, and the unemployed.[9]

Vague or Lax "Hardship Excuse" Standards

Many who do arrive in court try to escape jury service through a so-called "hardship" excuse. Standards for courts to excuse jurors for hardship are often lax, vague, or, at worst, nonexistent. For example, Washington allows courts to excuse jurors for "undue hardship, extreme inconvenience, public necessity, or any reason deemed sufficient by the court for a period of time the court deems necessary."[10] Some states even encourage judges to release anyone in a business or profession. For instance, Virginia allows courts to excuse prospective jurors who allege a "particular occupational inconvenience."[11] Virtually anyone who is gainfully employed and wishes to avoid jury service may meet this broad standard.

Administratively, many jurisdictions signal to their citizens that jury service is not an important responsibility. Several state statutes authorize judges to delegate the granting of excuses to court clerks or other staff. In some courts, a quick telephone call to the clerk or merely checking a box on a form with a prepaid return envelope may suffice. If those seeking a hardship excuse had to appear before a judge, it is doubtful that many would risk inventing or exaggerating an alleged hardship. Further easing the way to an exemption, most state statutes do not require summoned jurors to provide the court with written verification of the claimed hardship, such as a statement from an employer, a doctor's letter, or proof of caretaker responsibilities.

Financial Hardship

Financial hardship can be a legitimate reason for excusing jurors from service. Many jurisdictions offer jurors no more than what is essentially lunch money and a bus

token after the first day of service. According to the National Center for State Courts, the average juror compensation from the court for less than five days of service is about $18.53 per day.[12] After five days, this stipend increases to an average of $24.26 per day of service.[13] The lack of adequate compensation may be particularly troublesome for jurors who are selected to serve on the rare, lengthy trial.

Lack of adequate compensation for jurors has several unfortunate results. Some jurors may simply not show up in court. Others are likely to arrive and claim financial hardship. Courts presented with such claims often find they have no choice but to excuse workers because they do not have the resources to provide any significant compensation above the small jury fee. Consequently, the basic democratic right to be tried by a jury of one's peers may be largely illusory in a system whose juries are disproportionately composed of retired and unemployed individuals, especially in lengthy trials. Such juries may be non-diverse and unrepresentative, and may produce arbitrary results for plaintiffs, defendants, and prosecutors.

The Length and Inflexibility of Jury Service

Citizens called to jury service have other obligations. They have jobs that require their presence, children or other family members for whom they are responsible, travel plans that cannot be altered without penalty, and other personal and professional commitments. Too many courts require potential jurors to waste enormous amounts of time waiting at the courthouse for possible assignment. For example, in Kentucky, jurors are advised that "[i]n some metropolitan areas, a person may be required to serve as few as fourteen days, while in some rural areas, a person may be asked to serve as many as 150 days."[14] Idaho requires citizens to serve up to ten days of jury duty and be available for as long as six months for service within any two-year period.[15] In Washington, a juror may be required to be physically present at the courthouse for two weeks or longer.[16] In these and other jurisdictions, the commitment of two weeks or more causes severe disruption in domestic schedules, personal plans, and business activities.

Another deterrent to jury service is the inflexibility of many court systems in accommodating the demands of juror calendars. Courts summon jurors to appear on a certain date and do not give them a simple means of rescheduling their service should they have a conflict. If juries in this country are to be truly representative of their communities, courts must accommodate professionals who face the demands of business and travel commitments. These citizens are productive and efficient at work, and they expect public service to be the same. While idealists might expect jury service to trump all other considerations, busy workers resent obligations that waste their time. This stands in the way of attaining diverse, representative juries.

Lack of a Significant Deterrent

Research shows that a significant number of those who do not respond to jury summonses fail to do so because they have little fear of receiving a penalty, or believe that the penalty will be a mere "slap on the wrist." For instance, in Illinois, failure to respond to a jury summons is punishable as contempt of court, with a fine ranging between $5 to $100.[17] Likewise, Virginia courts may punish no-shows with a fine of between $25 and $100, and Vermont jurors may face a minimal $50 fine.[18] Courts may waive these small fines if a juror provides "good cause" or a "satisfactory excuse" for why he or she failed to appear. When the penalty for not showing up for jury service has little more sting than a parking ticket, it is no wonder that so many people disregard their jury summons. Furthermore, most jurors have figured out that even these minor threats are hollow because many courts do not penalize no-shows.

Protecting the Right to a Representative Jury

Model legislation – the Jury Patriotism Act – has been developed by the American Legislative Exchange Council ("ALEC") to addresses the discouraging state of jury participation in America. The Act addresses the five major reasons citizens avoid jury service: occupational exemptions, the lack of coherent standards for excusing jurors from service, the financial burden jury service can impose, the insensitivity and inflexibility of courts toward the schedules of prospective jurors, and the absence of a penalty sufficient to deter people from avoiding their jury service obligation.

Elimination of Occupational Exemptions

The first principle of the Jury Patriotism Act is that all citizens have a civic obligation to serve on juries regardless of their occupation or income level. This cross-section of the public is necessary to ensure a diverse and representative jury, and to distribute the burden of jury service equally throughout the population. The first step to a more representative jury is the elimination of occupational exemptions from jury service. The Jury Patriotism Act repeals state laws establishing or recognizing such exemptions.

Limit the Grounds for Excuses

The Act also addresses the problem of vague and undefined "hardship" excuses that exist in many states by providing greater guidance to courts regarding acceptable reasons for excusing a prospective juror from service. Under the Act, a prospective juror seeking a hardship excuse must demonstrate that jury service would cause "undue or extreme physical or financial hardship" to him or her or to a person under his or her care or supervision. Since defining similar standards has proven problematic in many jurisdictions, the Act is explicit. It recognizes only three acceptable bases for the court to grant a juror an excuse for hardship: (1) the impossibility of obtaining an appropriate substitute caregiver for a person under the prospective juror's personal care or supervision; (2) the incurring of costs that would have a substantial adverse impact on the payment of the individual's necessary daily living expenses or on those for whom he or she provides the primary means of support; or (3) physical illness or disease. Absence from employment is

expressly excluded as a sole basis for excusing a potential juror from service.

In order to address the liberal granting of requests for an excuse, the Act permits only members of the judiciary, and not court employees, to authorize excuses. Jurors must also provide the judge with documentation supporting their request for an excuse. These grounds and procedures would more closely reflect true hardship and limit the opportunity for abuse.

Provide One Automatic Postponement of Jury Service

The Jury Patriotism Act recognizes that jury service is time consuming and, therefore, disruptive. For this reason, the Act grants every prospective juror the right to one postponement without cause, and it empowers jurors to set a date within six months of receiving their summons on which they will appear. Given that most jury service ends within one week, providing jurors with up to six months notice should allow them ample time to plan for their participation without undue stress or inconvenience. The courtesy of a postponement procedure would reduce the incentive for professionals who have commitments to patients and clients, or others who have family responsibilities or vacation plans, to avoid jury service. As the American Bar Association has observed, "[d]eferral of jury service accommodates the public-necessity rationale upon which most exemptions and automatic excuses were originally premised, while enabling a broader spectrum of the community to serve as jurors."[19]

Obtaining a first postponement of service under the Jury Patriotism Act would be quick and easy. Individuals would simply request the postponement by telephone, online, in person, or in writing. A potential juror would not have to provide any reason for the postponement – only a date on which he or she will appear for jury service within six months. The Act sets a higher standard, however, for future postponements. Additional deferrals may be granted only in the event of an extreme emergency, defined as a death in the family, sudden grave illness, a natural disaster, or a national emergency in which the juror is personally involved. These grounds must be such that the summoned juror could not have anticipated them at the time he or she requested the initial postponement.

Adopt a Uniform One-Day/One-Trial System

A shorter term of service would also relieve some of the hardship currently placed upon jurors. The Jury Patriotism Act guarantees that a potential juror would not be required to spend more than one day at the courthouse unless he or she is selected to serve on a jury panel. This practice, known as the "one-day/one-trial" system, has been adopted by about half of the state courts.[20] Over the past three decades, courts have transitioned to the one-day/one-trial system as a response to high excusal rates, the inconvenience and hardship resulting from lengthy terms on those who are unable to obtain an excuse, and the frustration and boredom imposed on jurors by lengthy terms of service.

The one-day/one-trial system works. When New York adopted the one-day/one-trial system, it reduced its statewide average term of service, previously over five days, to just 2.2 days.[21] Under the one-day/one-trial system, 85% of Massachusetts jurors complete their service in just one day and 95% finish in three days.[22] Not only does the one-day/one-trial system result in less time spent in the courthouse for jurors, it also means fewer days of employee absences from work for jury duty. Research by the California Judicial Council found that the majority of employees returned to work the next business day after reporting for jury service under the one-day/one-trial system.[23]

Jurors favor the one-day/one-trial term of service. In an early study of juror attitudes, 90.8% of 5,500 jurors selected the one-day/one-trial system as preferable to a thirty-day term, and a majority would not object to being called again.[24] The one day/one-trial system term also may vastly reduce the need for hardship excuses. One court found that requests for excusal after the adoption of the one-day/one-trial system fell to 1.36%, and most of these requests were accommodated by the court's postponement policy.[25] It should be no surprise that the survey also revealed that the one-day/one-trial system increased positive attitudes about jury duty and about the justice system generally.[26] Recently, the National Center for State Court's Best Practices Institute recognized the one-day/one-trial system as a particularly effective practice.[27]

Wage Replacement or Supplementation

Better compensation for jurors may be key to obtaining more representative juries. The Jury Patriotism Act takes steps to address the financial hardship issues that undermine citizen participation in civil trials. The Act provides wage replacement or supplementation through a "lengthy trial fund" financed by court filing fees. Jurors who serve on civil trials lasting longer than three days would receive supplemental compensation if they would otherwise be excused from service due to financial hardship.

Provide Special Compensation to Jurors on Lengthy Trials

The number of jurors called to serve on lengthy trials is relatively small, but those who find themselves in that situation may suffer severe financial hardship as a result. While jurors have an obligation to serve, there is a limit on how much an individual citizen can be asked to sacrifice for the civil justice system, particularly when the case involves a dispute between private parties. For this reason, the Jury Patriotism Act would help relieve the heightened burden on jurors serving on lengthy civil cases. The fund would provide jurors who are not fully compensated by their employers with increased wage replacement or supplementation after the ninth day of service.

Increase the Penalty for No-Shows

As discussed above, most states currently threaten no-shows with contempt of court, punishable by a small fine or even a few days in jail; but rarely is any penalty imposed. Jury service, however, is an important obligation of citizen-

ship and a critical part of the criminal and civil justice systems. Those who disregard a jury summons compromise the judicial system and jeopardize the rights of litigants. For this reason, the Jury Patriotism Act punishes a failure to appear as a misdemeanor. This penalty should communicate to jurors the importance of jury service.

Conclusion

Americans overwhelmingly support the jury system. Yet, many people fail to appear for jury duty when summoned, or strive to get out of jury duty once they enter the courthouse. Most of these individuals do not lack a sense of civic duty. Rather, they are discouraged from jury service as a result of hardship and headache imposed by antiquated systems that do not provide adequate financial compensation, leave little or no flexibility as to the dates of service, and may involve unnecessary time sitting around in a waiting room. Moreover, loosely defined hardship exemptions provide many with an easy means of escape. ALEC's Jury Patriotism Act identifies and addresses the major causes of low jury participation in all levels of society; it will make jury service more flexible, less burdensome, and more attractive. State legislatures should adopt the Act. Courts also should do their part to make sure that the burdens of service are shouldered by all, and the promise of a fully representative jury becomes a reality in every courtroom in America.

* Keith T. Borman is the managing partner of the Washington, D.C. office of Shook, Hardy & Bacon L.L.P. He received his B.A. from Occidental College in 1970 and his J.D. from the University of Michigan Law School in 1973.

Mark A. Behrens is a partner in the Public Policy Group of Shook, Hardy & Bacon L.L.P. in Washington, D.C. He is Vice-Chair (Programs) of the Federalist Society's Litigation Practice Group, Advisor to the American Legislative Exchange Council's Civil Justice Task Force, and co-counsel to the American Tort Reform Association. Mark received his B.A. in Economics from the University of Wisconsin-Madison in 1987 and his J.D. from Vanderbilt University in 1990, where he served on the *Vanderbilt Law Review*.

Footnotes

[1] *See* U.S. Const. art. III, § 2, cl. 3 and amend. VI; U.S. Const. amend. VII. Most state constitutions also establish a right to a jury trial in civil matters. *See, e.g.*, Conn. Const. art. I, § 19; Fla. Const. art. I, § 22; Pa. Const. art. I, § 6; Va. Const. art. I, § 11.

[2] Alexis de Toqueville, Democracy in America, vol. 1, at 285 (J. P. Mayer ed. 1975).

[3] *See* Am. Bar Ass'n, Perceptions of the U.S. Justice System 6-7 (1998), *available at* <http://www.abanet.org/media/perception/perceptions.pdf> (last visited Jan. 14, 2003).

[4] *See* Robert G. Boatright, Improving Citizen Response to Jury Summonses: A Report With Recommendations vii (Am. Judicature Soc'y 1998).

[5] *See* Amy Merrick, *When the Jury Box Runs Low, Deputies Hit Wal-Mart: Personal Summonses Get Job Done When Mail Doesn't; Out for Milk, Off to Court*, Wall St. J., Aug. 20, 2002, at A1.

[6] *See* Boatright, *supra* note 4, at 13. Others have estimated that as many as two-thirds of the approximately 15 million Americans summoned do not report for jury service. *See* David Schneider, *Jury Deliberations and the Need for Jury Reform: An Outsider's View*, Judges' J., vol. 36, no. 4, at 25 (Fall 1997).

[7] *See* Nev. Rev. Stat. § 6.020(1)(d) (2001).

[8] *See* Wyo. Stat. Ann. § 33-16-105 (Michie 2002).

[9] Am. Bar Ass'n, Standands Related to Juror Use and Management 51 (1993) [hereinafter ABA Standards].

[10] Wash. Rev. Code § 2.36.100(1) (2002).

[11] Va. Code Ann. § 8.01-341.2 (Michie 2002).

[12] *See* Nat'l Center for State Courts, Examining the Work of State Courts, 2001, at 90 (2002), *available at* <http://www.ncsconline.org/D_Research/csp/CSP_Main_Page.html> (last visited Jan. 14, 2003) (based on 1999 statistics).

[13] *See id.*

[14] Admin. Office of the Courts, Commonw. of Ky., You the Jury: Kentucky Jury Handbook 4 (2001), *available at* <http://www.kycourts.net/Resources/You_the_Jury_%20Handbook.pdf> (last visited Jan. 14, 2003).

[15] *See* Idaho Code § 2-216 (2002).

[16] *See* Wash. Rev. Code § 2.36.100 (2001). Implementation of this requirement varies by county.

[17] *See* 705 Ill. Comp. Stat. 305/15 (2002); *see also* Tex. Gov't Code Ann. § 62.111 (Vernon 2001).

[18] *See* Va. Code Ann. § 8.01-356 (Michie 2002); Vt. Stat. Ann. tit. 4, § 958 (2002).

[19] ABA Standards, *supra* note 9, at 51.

[20] *See* Nat'l Center for State Courts, Best Practices Inst., *Jury Administration and Management: Term of Service*, *available at* <http://www.ncsconline.org/Projects_Initiatives/index.htm#Best> (last visited Jan. 14, 2003) [hereinafter Best Practices].

[21] *See* N.Y. State Unified Court System, Continuing Jury Reform in New York State 12 (Jan. 14001), *available at* <http://www.courts.state.ny.us/juryreform.pdf> (last visited Jan. 14, 2003).

[22] *See* Office of Jury Commissioner for the Commonwealth, *Introduction*, <http://www.state.ma.us/courts/jury/introduc.htm> (last visited Jan. 14, 2003).

[23] S*ee* Don Wolfe, *Employers: Support Jury Service or Stop Complaining*, Silicon Valley / San Jose Bus. J., July 5, 2002, *available at* <http://www.sanjose.bizjournals.com/sanjose/stories/2002/07/08/editorial3.html> (last visited Jan. 14, 2003).

[24] *See* David E. Kasunic, *One Day/One Trial: A Major Improvement in the Jury System*, Judicature, Aug. 1983, at 81 (Aug. 1983) (citing a 1976 study of juror attitudes conduct by a professor with a specialty in statistics and sociology).

[25] *See id.* at 81-82.

[26] *See id.* at 81.

[27] *See* Best Practices, *supra* note 20.

"Fast Food":

The Next Tobacco?

*By Dwight J. Davis, Ann Driscoll and Jaime Schwartz**

In the Summer of 2002, three lawsuits were filed against Quick Service Restaurants ("QSRs") alleging that various classes of plaintiffs had suffered damages caused by eating what is commonly referred to as "fast food." Plaintiffs' counsel and the behind-the-scenes consumer advocates supporting him proclaimed that the fast food lawsuits arose from and would reflect many of the same tobacco litigation tactics that the tobacco plaintiff's bar has been trying to use against cigarette manufacturers.

> What we're trying to do is use some of the same legal tactics that have been so effective against the public health problem of smoking against the other public health problem of obesity.[1]

This paper will explore exactly what it means to employ "tobacco litigation tactics" and will survey the defenses that can be mounted against them. This paper concludes that the tobacco litigation tactics are destined for failure, not merely in the tobacco arena, but particularly in the QSR litigation. The nature of fast food is well understood by the consuming public, and it is factually and legally impossible to attribute liability for any particular individual's health to a QSR, as opposed to the choices, lifestyle and genetics of each individual. These simple and fundamental points can be expected to carry the day quickly in the QSR litigation.

This article begins with a brief history of tobacco litigation and an overview of the three complaints filed to date against QSRs. The article then offers a discussion and analysis of the application of plaintiffs' tobacco litigation tactics to the food industry and examines some of the key product attributes that should lead to the early dismissal of the fast food litigation.

Tobacco Litigation and The Development of "Tobacco Litigation Tactics"

The term "tobacco litigation tactics" as used in this paper refers to various evolving tactics that anti-tobacco advocates and members of the plaintiffs' bar engaged in during the long history of both the regulation of cigarettes and the litigation over the effects of those products. As will be seen in the brief review of the history that follows, the key tactics appear to consist of (1) generating negative publicity that demonizes the product and the manufacturer; (2) attempting to make the product socially unacceptable and convincing the government to join that effort; (3) without regard to the fact that sales to minors are illegal and that the companies do not sell cigarettes at retail, focusing on the use or consumption of the product by children and teenagers; (4) focusing on the manufacturer's so-called "manipulation" of, and preoccupation with, certain components of the product (alleging manipulation of nicotine, for example); (5) focusing on how demand for the product is allegedly caused by overpowering and omnipresent advertising and asserting that the product has no independent social utility; and (6) pointing to documents that are alleged to conflict with public positions or that reveal facts or internal thought processes that the company did not share with the public, without regard to whether the documents contain any new facts or not.

Brief History

It has been widely believed for more than 100 years that smoking presents health risks. It has also been part of common experience that smoking can be hard to quit. In the 1950s, scientists began publishing research showing statistically that most people who developed lung cancer had been smokers, and also showing that mouse skin painted with tobacco smoke condensate yielded excess skin tumors. These scientific reports were widely publicized, and the resulting publicity was characterized as a cancer scare, causing cigarettes to take a dip in popularity. This wave of negative publicity was followed by the first wave of tobacco litigation in the 1950s and 60s, as individuals who believed that smoking had caused them to develop a disease brought lawsuits against the company that manufactured the brand or brands they smoked. This first wave of litigation was unsuccessful for tobacco plaintiffs and their counsel as juries and courts rejected the claims because, for example, the medical proof failed or because the jury found that the smoker assumed the risk.

In 1964, the United States Surgeon General issued a landmark report on Smoking and Health and opined that "[c]igarette smoking is a health hazard of sufficient importance in the United States to warrant appropriate remedial action."[2] The issuance of the report was a watershed event that galvanized many interests groups, politicians and public health scientists against cigarettes. Later, legislation was passed requiring the first health warning on cigarette packages ("Caution: Cigarette Smoking May Be Hazardous To Your Health")[3] The required content of this federal warning was amended over the years, and additional reports were issued each year by the Surgeon General addressing various issues affecting smoking and health. In addition to requiring warnings, the federal legislation ultimately resulted in a ban on television and radio advertising of tobacco products commencing in 1972, and also led to required tar and nicotine statements in print advertising. Meanwhile, anti-tobacco advocates continued to work on various strategies to make smoking socially unacceptable and to devise legal theories that might permit new attacks on tobacco companies in courtrooms around the country.

In the mid-1980s, in a so-called "second wave" of tobacco litigation, plaintiffs attempted to take advantage of the expanding law of product liability and tried to fashion claims

of fraud, concealment, failure to warn, strict liability, negligence and breach of warranty. The cases were still traditional individual lawsuits, brought on behalf of a single smoker against the companies that manufactured the brands smoked by the plaintiff. One of the pivotal issues addressed by the courts in the second wave was the extent to which the Federal Cigarette Labeling Act (which required package warnings) expressly preempted state law tort claims against cigarette manufacturers. In 1992, a sharply splintered United State Supreme Court issued its plurality opinion in *Cipollone v. Liggett Group,*[4] and determined that from the effective date of the Labeling Act in July 1969, failure to warn claims, concealment claims and claims attacking advertising as undermining the warnings were all preempted, but claims of express fraud and express warranty survived express federal preemption.

From 1954 to 1994, the tobacco company defendants successfully defended approximately 813 lawsuits. Plaintiffs lawyers and anti-tobacco advocates tried to develop new legal and factual theories to divert attention from the choices and decisions of individual smokers. Anti-tobacco advocates theorized that smoking rates would decrease if smoking could be made socially unacceptable. They also theorized that tobacco plaintiffs might be able to avoid continuous courtroom defeats if tobacco companies and their products could be demonized in the eyes of the public. Since the 1960s, the percentage of the adult population that smoked had fallen from a high in the 40% range down to the present day levels of roughly one-fourth of the adult population by the 1990s.[5] The anti-tobacco advocates endeavored to find a way to make smoking by 25% of the population extremely unpopular to the 75% of the population that did not smoke. The movement began with vocal non-smokers complaining that they did not like the smell of smoke. Soon, there were efforts to ban smoking in restaurants, first in California in the mid-1980s and then across the country. Smoking was banned on various airline routes commencing in 1986. Bans in public and private buildings followed, and soon there were images of smokers huddled in the cold outside buildings, ostracized to enjoy the pleasure of a cigarette. By the early 1990s the opposition to secondhand smoke took on the garb of science, with the EPA declaring that exposure to environmental tobacco smoke could cause lung cancer.[6]

In 1994, Congress held hearings on the dangers of cigarettes. The hearings and the surrounding media blitz often focused on privileged documents that had been taken from one of the tobacco companies by one of its outside paralegals, who first tried unsuccessfully to extort money from the company in exchange for the documents and then violated an injunction against him by disseminating the documents to members of the plaintiffs' bar who were renowned for their success in asbestos cases. Eventually, these lawyers and their allied forces succeeded in generating media stories that made it appear to be news that cigarettes presented health risks and could be hard to quit and that all of this had just been discovered in tobacco company documents.

At approximately the same time, the plaintiffs' bar explored new procedural and substantive legal approaches in an effort to find a recipe for success against the companies in the courtroom. In an effort to avoid the individual issues that had thus far spelled defeat, an army of plaintiffs' firms –buoyed by the wave of negative publicity –banded together and filed a class action in federal court in New Orleans, Louisiana, seeking to represent a nationwide class seeking recovery for the so-called injury of addiction. The case was initially certified, but the Fifth Circuit reversed and decertified the class.[7] The plaintiffs' group responded by abandoning the idea of a nationwide class, and filed in its place a series of state class actions, trying to certify classes of injured smokers in each state. The bulk of these actions were rejected by the courts, which found that the same individual issues and state law variations that barred a nationwide class also barred each state class.

Separate from the efforts of this plaintiff lawyer consortium, a small Florida firm filed a flight attendant ETS class action in Miami that was settled, and also filed a nationwide class action on behalf of injured smokers, that was cut back to a Florida class.[8] In addition to these class actions, individual smokers have continued to file lawsuits.

Beyond the class action front, the plaintiffs' bar pursued the so-called "attorney general cases." The basic theory of these cases was to pair a state attorney general with one or more plaintiffs' firms, glued together with a contingent fee arrangement, and file a suit claiming that the state had spent billions on the health care costs of the smoking poor, and the tobacco companies should repay them. These claims were in the nature of subrogation claims, but the attorneys general sought to prove their claims without having to adduce proof from the individual smokers themselves. Eventually, an attorney general suit was brought or threatened in every state of the union. As in the class actions, the plaintiffs clamored for the companies to be punished for allegedly marketing to underage smokers who were said to be defenseless; for "manipulating nicotine"; for selling a dangerous product (even though Congress affirmatively makes it legal to do so); and for using attractive advertising. The companies eventually resolved the enormous claims being asserted in this litigation with a multi-billion dollar Master Settlement Agreement, which provides for payments to the states for 25 years and beyond, restricts advertising, and imposes other burdens as well. The private lawyers who banded together with the attorneys general received billions in fees, and the anti-tobacco advocates declared that their tactics had been successful. Meanwhile, however, the tobacco companies continue to prevail in numerous cases tried around the country, and although there have been some plaintiffs' verdicts, only one such verdict was upheld thus far through the completion of all appeals.

QSR Lawsuits

Attempt to Build Anti-QSR Public Sentiment:

As can be seen, tobacco litigation was often promoted by consumer advocates who sought and obtained

publicity aimed at increasing the public sentiment against smoking and encouraging programs and policies that ostracized and isolated the ever-shrinking minority of smokers. In a similar manner, some of those same advocates, like Professor John D. Banzhaf, III, have begun testing the waters of food industry litigation by filing several lawsuits, authoring articles aimed at inciting public outrage against the food industry, and appearing on talk shows and news programs such as CNN's "Crossfire." Banzhaf began by filing a class action against McDonald's Corporation, alleging that McDonald's misrepresented that its fries were acceptable for vegetarian diets. The parties settled this case for millions of dollars. Next, Banzhaf brought a lawsuit against Pirates Booty, a popular snack food, for mislabeling fat content. Banzhaf continued his crusade against the food industry by filing suit against Pizza Hut for mislabeling the content of "Veggie Lovers Pizza." The efforts of Prof. Banzhaf and others like him, such as Northeastern University Law School Professor Richard Daynard, have generated media attention on the nation's obesity problem and have attempted to point their collective fingers at the food industry as the new villain.

Like the early reports published by the American Cancer Society and the U.S. Surgeon General, health organizations are beginning to speak out against obesity as a health concern. For example, the Surgeon General's 2001 report entitled "Call to Action to Prevent and Decrease Overweight and Obesity" states that "[m]orbidity from obesity may be as great as from poverty, smoking, or problem drinking. Overweight and obesity are associated with an increased risk for coronary heart disease; type 2 diabetes; endometrial, colon, postmenopausal breast, and other cancers; and certain musculoskeletal disorders, such as knee osteoarthritis."[9]

Politicians and government agencies are beginning to speak and act against obesity. In 2002, Senator Bill Frist introduced INPACT, the Improved Nutrition and Physical Activity Act, aimed at combating the nation's obesity problem. On a smaller scale, the Los Angeles School District officially banned the sale of sodas. And in Maine, the State Department of Health asked families to cut back on their use of soft drinks citing a concern for nutrition. In short, there is an undeniable movement to spread alarm about the potential health risks associated with obesity and, as with tobacco, there is a move afoot by plaintiffs' lawyers to find a deep pocket that might be the next source of contingent fees.

Anti-Food Industry Lawsuits:

The plaintiffs' bar tested the waters with two lawsuits against QSR in mid-summer 2002. It was clear that these plaintiffs modeled their claims after the tobacco claims and immediately tried to rouse public sentiment in their favor. These lawsuits, however, were met with an onslaught of negative commentary from every part of the country and across the Atlantic.[10]

One of the class action lawsuits was filed on July 24, 2002 in the Eastern District of New York and named four well-known QSRs — McDonald's Corporation, Burger King Corporation, KFC Corporation, and Wendy's International. The plaintiff class was described as "individuals and consumers who have purchased and consumed the defendants' products and as a result thereof, have become obese, overweight, developed diabetes, coronary heart disease, high blood pressure, elevated cholesterol intake, and/or other detrimental and adverse health effects and/or diseases." The plaintiff asserted claims of negligence, fraud and product liability. The other test lawsuit was filed on July 12, 2002, against the same four defendants in the Supreme Court of the State of New York, Bronx County, on behalf of the same class of plaintiffs, and asserted the same causes of action. Apparently taken aback by the ridicule they suffered in the media, plaintiffs publicly announced they were withdrawing the lawsuits even before any of the defendants were served with the complaints.[11]

Similar to what transpired in the tobacco litigations, the plaintiffs' lawyers in the QSR lawsuits are refining their causes of action in an attempt to make them more likely to withstand a motion to dismiss for failure to state a claim and to make them more palatable to jurors. After the first two lawsuits met immediate ridicule both in the legal community and in the media, plaintiffs' counsel, with input from consumer advocates with tobacco industry litigation experience, refined the complaint and filed *Pelman v. McDonald's* on August 22, 2002 in the Supreme Court of the State of New York, Bronx County. The lawsuit was later removed to the Federal District court for the Southern District of New York. The purported class is similar to the class alleged in the first two class actions[12] but adds a new category of class members consisting of children –alleged to be innocent victims without the ability to select their own diets and unable to resist the draw of advertising techniques. Unlike the previous complaints, however, this complaint was actually served on its defendants. In November 2002, the defendants in *Pelman* filed a motion to dismiss the complaint on the grounds that (1) there is no duty to warn about the ingredients and characteristics of ordinary food; (2) that plaintiff cannot as a matter of law establish that it was the defendants' products that caused the alleged injuries; (3) that the public cannot be deceived about the characteristics of products that are commonly known and understood; and (4) that public policy disfavors the expansion of the outer boundaries of tort liability. The United States District Court for the Southern District of New York ruled on the motion on January 22, 2003, dismissing the complaint on procedural grounds.

Flawed Logic: What is wrong with the food industry lawsuits?

Contrary to the anti-tobacco hype and as explained above, tobacco litigation tactics have not been successful, even in tobacco litigation — unless, of course, one considers the vast transfer of wealth to a relatively small number of lawyers a success. But, the process of whipping up negative publicity and attempting to both demonize the product and portray users as uninformed sheep in the hopes of a favorable litigation outcome has even less of a chance of success with food products.

Legal Differences

Obesity plaintiffs will face extreme difficulty in attributing their obesity to the fast food of a QSR. In cigarette cases involving lung cancer, there is a well-developed body of statistical evidence that associates lung cancer with smoking. A number of tobacco companies have established websites pointing out that smoking cigarettes can cause disease. While each tobacco plaintiff must prove that his or her specific condition was caused by smoking, there is an established body of evidence that assists the plaintiff in making that claim in a cigarette case. By contrast, causation –even general causation – should be exceedingly difficult to establish in a case filed against a QSR.

It would be extremely difficult, if not actually impossible, for a plaintiff to prove that his or her health problems were caused by eating a product manufactured, distributed or sold by a QSR. Quite simply, there are far too many other factors contributing to weight gain including genetics, lack of physical activity and every other type of food ingested by the plaintiff that was not from the defendant's restaurant. Even after plaintiffs hurdle the phase of general causation – it is possible that one food made me fat – they will be faced with proving that being fat was the cause of a specific health malady. The food defendants will have no problem identifying overweight people who are healthy as professional athletes or skinny people who suffer the exact same affliction as the plaintiffs.

The product liability allegations are equally flawed. Since 1966, cigarettes have been labeled as dangerous. This is not the case for fast foods. Assuming that plaintiffs could somehow portray "fast food" as a dangerous product for which its manufacturer should have warned the public of the potential harm, the plaintiffs would face a second hurdle in showing that a warning would have made a difference in a consumer's food choice and also that the different food choice would have made an impact on their health.[13] A showing of this chain of causation seems highly doubtful. Likewise, allegations that QSRs failed to label the nutritional content of their products is inaccurate since many of the QSRs restaurants, including the QSRs already named as defendants, voluntarily post the nutritional content of their products and have done so on a voluntary basis since the early 1990s when Congress passed the Food Labeling Act.[14] The information is also available on the internet web sites of each of the name defendant QSRs. Indeed, although not covered by the Food Labeling Act, the QSRs typically post more in formation and more detailed information than that which the government requires of food manufacturers that are covered by the Act.

The applicability of theories of product liability to food products has been addressed by the legal community in the Restatement of Torts.[15] Section 402A of the Restatement states that one will be liable for "any product [sold] in a defective condition unreasonably dangerous to the user or consumer." The comments to this section of the Restatement shed further light on the inapplicability of product liability claims against the QSRs. First, comment i states that "[m]any products cannot be made entirely safe for all consumption, and any food or drug necessarily involves some risk of harm, if only from over-consumption."[16] Likewise, comment j explains that "a seller is not required to warn with respect to products, or ingredients in them, which are only dangerous, or potentially so, when consumed in excessive quantity, or over a long period of time, when the danger, or potentiality of danger, is generally recognized." The Restatement identifies liability only when a product is either defective in design or is defective because of inadequate instructions or warnings,[17] but comments that the test for a design defect is "whether a reasonable alternative design would, at reasonable cost, have reduced the foreseeable risks of harm posed by the product and, if so whether the omission of the alternative design by the seller…rendered the product not reasonably safe."[18] In sum, the applicability of a product liability claim against the food industry has already been addressed and dismissed.

The food industry plaintiffs also rely on claims of fraud and deceit as state law causes of action. In particular, plaintiffs claim violation of the New York Consumer Fraud Statute,[19] which prohibits deceptive acts or practices in the conduct of any business, trade or commerce as well as false advertising.[20] The law, however, applies to the *reasonable* consumer and raises the immediate threshold question: did the defendants mislead the reasonable consumer? The public ridicule that immediately resulted from the filing of the QSR lawsuits was almost unanimous in the position that these lawsuits were without a basis and shows that the reasonable consumer was not misled. The food companies should not, however, assume those good feelings will continue. Early suits against tobacco companies were also ridiculed. To avoid the erosion of popular support, food companies must not allow the zealots to feed "junk science" to the media unanswered.

The food industry should also be able to ward off class actions. The food industry is extremely fragmented. Even if plaintiffs try to focus on one segment of that industry, QSRs, each defendant sells a multitude of different products. The availability of "warnings" at the different QSRs should also prevent class certification of these issues. Questions of what a consumer knew and when he knew it will predominate over individual issues leading to denial of class certification and greatly reduce the precedential value of a finding in an individual suit. Thus, even in the most class-action-favorable venues in America, it is extremely unlikely that a substantial case could be certified.

Product Differences

Another fatal problem with the claims brought against QSRs is that as a product, food is vastly different from tobacco and as an activity, eating is vastly different from smoking. Every single ingredient used in a food product sold at a typical QSR has been found to be Generally Recognized as Safe ("GRAS") by the federal government. Even in its recent broadside on the dangers of obesity, the Office of the Surgeon General was quick to point out that individual foods are not, in and of themselves, bad.[21]

If there is an analogy to be drawn here at all, perhaps it can be said that food is more like alcohol. Food is a product that can be consumed without harm to oneself or to others. Like alcohol, problems with food products arise only when an individual abuses the use of the product through over consumption. The Restatement of Torts, which provides that "good tobacco" is not defective just because it is dangerous, also provides that "[g]ood whiskey is not unreasonably dangerous merely because it will make some people drunk."[22] Similarly, QSR products are not unreasonably dangerous merely because it will make some people who abuse it gain weight.

Whereas smokers have been a minority of the total population for decades, the same cannot be said of consumers of fast food products. Unlike tobacco, there is no minority user that government might seek to unfairly oppress. Because smoking currently only affects a minority, it has been easier to pass legislation that prohibits smoking in public places, regulates advertising, and to levy confiscatory taxes on the product through attorney general suits and punitive verdicts. In contrast, it would be a near-impossible task to find a person who has not eaten some form of fast food. It is a product consumed and enjoyed by the vast majority of consumers who are not likely to sit back and suffer through its regulation, indirect taxation or prohibition.

Practical Difference

Juries frequently hold tobacco plaintiffs accountable for their decision to smoke. With regard to QSR plaintiffs, it is likely that the freedom of choice defense they will face will require an examination of all the food choices that the plaintiffs have made and an examination of the exercise choices that they have made, or more likely not made, over their lifetimes. It is likely that jurors will hold plaintiffs accountable for their dietary selections and sedentary lifestyles.

To avoid personal responsibility, contributory negligence and assumption of the risk, some tobacco plaintiffs claimed that they became addicted to cigarettes in their teens and supposedly could not quit thereafter. In sharp distinction, however, plaintiffs in the QSR litigation do not appear to contend that there is some substance in fast food that forces them to consume it against their will.

Finally, it is likely that QSR plaintiffs will try to portray the plaintiffs as helpless children. Magazine covers with children displaying a balloonish girth have already appeared. It is not by accident that the plaintiffs in the third QSR lawsuit are children as opposed to the plaintiffs in the first two lawsuits who were middle-aged adults. Children are believed to have a lower threshold of resistance to advertising and in all likelihood were taken to the QSR by an adult, perhaps a parent. Banzhaf has already boasted that traditional defenses like contributory negligence or assumption of the risk do not apply to children.[23]

On a very practical level, jurors will know the plaintiff toddlers did not buckle themselves in car seats and drive themselves to the drive through window. They were taken there by their parents – the very parents who did not exert enough control to prevent their children from gorging themselves and now want to share in a multi-million dollar claim. Jurors will not absolve the parent of their responsibility for the dietary choices they made for their children.

Conclusion

On January 22, 2003, the United States District Court for the Southern District of New York dismissed the complaint filed in *Pelman v. McDonalds*. It is doubtful, however, that this will be the last of the food industry lawsuits. Indeed, if the attorneys and advisors are serious in their devotion to their tobacco litigation tactics, then it is safe to say that this is just the beginning of litigation against the food industry and that plaintiffs' attorneys and advisors will continue to try to build public sentiment in their favor and will refine and polish their claims. Ultimately, it will be widespread knowledge of the nature of fast foods and common sense that will bring the fast food litigation to its knees.

* Mr. Davis, Ms. Driscoll, and Ms. Schwartz are in the New York office of King & Spalding and currently represent Wendy's International, Inc., in the class action litigation described herein. Mr. Davis is a member of the Federalist Society.

Footnotes

[1] *After Tobacco Suits, Lawyers Target Fast Food*, *at* http://www.cnn.com (Aug. 19, 2002).

[2] Public Health Service, U.S. Department of Health Education & Welfare, Pub. No. 1103, *Smoking and Health: Report of the Advisory Committee to the Surgeon General of the Public Health Service* (1964).

[3] The 1970 Federal Cigarette Labeling and Advertising Act, 15 U.S.C. § 1334 (1970).

[4] 502 U.S. 504 (1992).

[5] American Lung Assoc. Best Practices and Program Services Epidemiology and Statistics Unit, *Trends in Tobacco Use*, Table 4 (2002), *available at* www.lungsusa.com.

[6] *Respiratory Health Effects of Passive Smoking: Lung Cancer and Other Disorders*, 1993. The validity of this report has been the subject of litigation. *See e.g.*, *Flue-Cured Tobacco Co-op Stabilization Corp. v. United States EPA*, 4 F. Supp.2d 435 (N.D.N.C. 1998), *vacated*, 2002 WL 31759899 (4th Cir. 2002).

[7] Castano v. American Tobacco Co., 84 F.3d 734 (5th Cir. 1996).

[8] *Engle v. RJ Reynolds Tobacco*, No. 94-8273. In *Engle*, a jury has entered a $145 billion punitive damage award in favor of a Florida class, even though all class members have yet to try their individual claim, with the exception of three individual class members. The *Engle* verdicts are now on appeal.

[9] U.S. Dep't of Health and Human Services, *The Surgeon General's Report*, *Call to Action to Prevent and Decrease Overweight and Obesity*, (2002).

[10] Mike Thomas, *Imagination Is All You Need to Feed from Litigation Trough*, Chicago Sun Times, Jul. 31, 2002; Cosmo Macero, Jr., *Caesar Barber Is Bringing the Business of Obesity Full Circle*, Boston Herald, August 2, 2002; *Oh, Temptation- Fast Food Lawsuits*, The Economist, Aug. 3, 2002; Tom McEnaney, *Alltracel Fights the Flab*, Sunday Times (London), August 4, 2002; Peg Tyre, Sally Abrahms & Jennifer Lin, *Fighting 'Big Fat'; An Army Is Mobilizing in A War Against Junk Food. The Combatants: Doctors, Lawyers, Preachers And Moms*, Newsweek, Aug. 5, 2002; Amanda Ursell, *On Nutrition Feel Full on Fewer Calories: Pick the Right Foods*, Los Angeles Times, Aug. 5, 2002.

[11] The first of the two class actions mentioned was voluntarily withdrawn on August 2, 2002. The second class action mentioned was not

withdrawn, but the lawsuit died after plaintiffs failed to serve it within 120 days of filing. N.Y. C.P.L.R. § 306-b (McKinney 2002).

[12] "New York state residents, infant-individuals, and consumers who have purchased and consumed the Defendant's products and as a result thereof, have become obese, developed diabetes, coronary heart disease, high blood pressure, elevated cholesterol intake, and/or detrimental and adverse health effects and/or diseases, as a result of their respective conduct and business practices as mentioned hereinafter."

[13] The Ninth Circuit recently appeared to recognize the parallels between a smoker's claims that he was ignorant of the well-known dangers of tobacco and the claims of burger eaters who claim they were unaware what might happen if they consumed too many. *See Soliman v. Philip Morris, Inc*., 311 F.3d 966, 970 n.6 (9th Cir. 2002).

[14] 21 U.S.C. § 343 (2002).

[15] RESTATEMENT (SECOND) OF TORTS § 402A (1965).

[16] *Id*. at cmt. i.

[17] *Id*. at 402A.

[18] *Id*. at cmt. d.

[19] N.Y. GEN. BUS. LAW § 349-50 (McKinney 2002).

[20] *Id*.

[21] *The Surgeon General's Report*, *supra* note 9.

[22] RESTATEMENT (SECOND) OF TORTS § 402A (1965).

[23] *Crossfire* (CNN television broadcast, Sept. 2, 2002).

Professional Responsibility

Pro:

Why *Central Bank* Should Be Overruled

*By Roger C. Cramton**

The lawyer's primary function is to counsel and assist clients in conduct that is "within the bounds of the law." The fundamental limitation on what lawyers may do for clients is stated in ABA Model Rule 1.2(d) as follows: "A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent ...." "Knows" is defined in Rules 1.0(f) as "actual knowledge of the fact in question," but broadened by the qualification that "[a] person's knowledge may be inferred from circumstances." The modern justification of the attorney-client privilege and the professional duty of confidentiality, a leading case tells us, is "to encourage full and frank communication between attorneys and their clients and thereby promote broader public interests in the observance of law and administration of justice." The underlying assumption justifying lawyer confidentiality is that the "fully informed" lawyer will channel client conduct along lawful paths, furthering the public interest in "observance of law."

Most lawyers, most of the time, observe this fundamental duty. But lawyers are not above the law and they as well as others must be deterred from seeking short-term gain in assisting a client in illegal but profitable activities. Embarrassment at being caught and loss of peer repute operate in some professional communities as an effective restraint. But the growth in the size and dispersion of the profession and the dilution of personal responsibility flowing from practice in large organizations requires sturdy means of compensating those harmed by lawyers who wilfully or negligently assist a client's fraud and punishing lawyers who similarly assist a client's crime.

Professional discipline plays virtually no role in complex regulatory or corporate frauds or crimes. The applicable professional rules are ambiguous, sometimes discretionary and lawyer protective. The cases involve factual complexity and cost exceeding the staff and resources of disciplinary authorities. Only if the lawyer is convicted of a felony will these harms to third persons and the public result in professional discipline. The interests of third persons and the public are largely protected by the potential threat of civil and criminal liability and, now that Sarbanes-Oxley §307 is operative, SEC regulatory sanctions.

In 1994 the Supreme Court, reversing longstanding authority in all federal circuits, held in the *Central Bank* case[1] that a secondary actor in a securities transaction (e.g., an accountant or a lawyer) is not liable for damages for aiding and abetting a securities law violation. The decision did not rest on a policy determination that aiding and abetting liability of professional advisers is undesirable. Instead, the majority revisited the text of §10(b) of the 1934 Act and held that it did not explicitly authorize a private cause of action in this situation. The 1995 amendments to the 1934 Act also did not repudiate aiding and abetting liability for professional advisers; to the contrary, the SEC was specifically empowered to go after aiders and abettors for securities law violations. Aiding and abetting is also unlawful, and actionable, under state criminal and tort law and under some state securities statutes.

Central Bank's elimination of accessory liability requires that claims under §10(b) of the Securities Exchange Act of 1934 be framed as primary violations. Civil liability actions against accounting and law firms in a fraud situation now must cast them as primary violators of §10(b). Under *Central Bank* the plaintiffs must show that a defendant actually engaged in manipulative or deceptive acts or made fraudulent representations. As the *Central Bank* decision put it:

> Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable.[2]

The federal courts of appeals are divided on whether primary liability reaches a professional adviser who stays in the background, writing and approving the fraudulent financial statement or solicitation, but who does not make a misrepresentation in person, provide a legal opinion, or whose name is not included in the document. Several courts of appeals have upheld primary liability when the complaint alleges that the lawyer, aware of their falsity, anonymously drafted false representations that were relied on by investors;[3] on the other hand, other circuits have struck down such complaints.[4]

My own view is that it is wrong to make liability turn on whether or not the substantial participation of the professional adviser is concealed. Why should an anonymous draftsman escape responsibility for knowingly fraudulent representations merely because his identity is concealed? My position does push the margins of primary liability and the uncertainty on this question provides a strong argument for statutory overruling of *Central Bank* to permit aiding and abetting claims to be brought against lawyers and accountants. The lawyer, present at the time the fraud is committed and having reason to know about it, who substantially participates in facilitating the fraud, should be accountable to those who are harmed. The recent decision denying motions to dismiss in the lawsuit by Enron shareholders against Enron's lawyers, accountants and investment bankers sug-

gests that the courts will extend primary liability if secondary liability is not recreated.[5]

Restoration of aiding and abetting liability under federal securities laws would not establish a novel principle or have untoward consequences. As already indicated, lawyers and other professional advisors are engaged in counseling and assisting clients. Legal rules, the profession's own ethics rules, and the civil and criminal law throughout the country prohibit and punish lawyers who aid and abet a client's crime or fraud. The existence of civil liability for aiding and abetting a federal securities law violation for the half-century prior to *Central Bank* did not threaten the viability or health of the accounting or legal professions or have other harmful consequences. On the contrary, the existence of such liability was a primary deterrent to wrongful conduct.

During the 1990s changes in the law and in professional practice have had the effect of leading accountants and lawyers to believe that they were immune from legal liability when acquiescing in the desires of corporate managers to ignore legal limits on corporate conduct, resulting in many situations in which illegality was assisted. Legal risks declined because of *Central Bank* and other decisions;[6] the enactment in 1995 of the Private Securities Litigation Reform Act of 1995 raised pleading standards, substituted proportionate liability for joint and several liability, restricted the application of RICO to securities fraud class actions, and provided a safe harbor for forward-looking information.[7] The SEC, which retained broad regulatory and enforcement authority, was hampered in carrying out its responsibilities by limited staff and funding.

Meanwhile, in the private sector dramatic changes in the organization, size, and culture of law practice encouraged reckless compliance with the requests of demanding corporate clients.[8] The spread of limited liability partnerships accentuated the willingness of partners to ignore the risks that other partners were taking. Today's emphasis on the "bottom line," both in corporations and law firms, gives rise to a culture valuing the false prestige and status that flows from being among the leaders in the annual listings of profits per partner. The result is a systemic problem that requires systemic solutions, and one of them is the statutory overruling of *Central Bank.*

* Roger C. Cramton is the Robert S. Stevens Professor of Law Emeritus, Cornell Law School.

Footnotes

[1]*Central Bank of Denver v. First Interstate Bank of Denver*, 511 U.S. 164 (1994). For discussion of the effect of *Central Bank* on secondary actors, see Jill E. Fisch, *The Scope of Private Securities Litigation: In Search of Liability Standards for Secondary Defendants,* 99 Colum. L. Rev. 1293 (1999); Melissa Harrison, *The Assault on the Liabilty of Outside Professionals: Are Lawyers and Accountants Off the Hook?*, 65 U. Cinc. L. Rev. 473 (1997); and Douglas M. Branson, *Chasing the Rogue Professional After the Private Securities Litigation Reform Act of 1995,* 50 SMU L. Rev. 91 (1996).

[2]511 U.S. at 191.

[3]See *Klein v. Boyd*, Fed. Sec. L. Rep. (CCH) & 90,136, vacated on grant of rehearing en banc (3rd Cir. 1998) (lawyer "spoke" to the investors by drafting the solicitation documents even though his identity was unknown to those solicited); *In re Software Tools*, 50 F.3d 615 (9th Cir.1994) (substantial participation in drafting is sufficient if there is "a reasonable inference that [the firm] knew or recklessly disregarded false information").

[4]*Anixter v. Home-States Production Co.*, 77 F.3d 1215 (10th Cir.1996) (no primary liability for representations made by others); and *Ziemba v. Cascade International Inc.*, 2001 U.S. App. Lexis 15529 (11th Cir.2001) (complaint must include an allegation that law firm made misrepresentations or omissions upon which the investors relied).

[5]*In re Enron Corp. Securities Derivative & ERISA Litig.*, 2002 WL 31854963 (S.D.Tex. Dec. 20, 2002).

[6]E.g., Lampf v. Gilbertson, 501 U.S. 350, 359-61 (1991) (significantly shortening the statute of limitations applicable to securities frauds).

[7]Pub.L. No. 104-67, codifying scattered sections of 15 U.S.C.

[8]See John C. Coffee, Jr., Understanding Enron: "It's About the Gatekeepers, Stupid," 57 Bus. Law. 1403 (arguing that during the 1990s the expected liability costs associated with gatekeeper acquiescence in managerial misbehavior went down while the expected benefits went up, resulting in many corporate restatements, failures and frauds).

Con:
It's Not Our Job

*By Steven C. Krane**

Lawyers have traditionally been able to provide their clients with dispassionate legal advice based on a full understanding of the relevant facts. Because of the evidentiary privilege that attaches to attorney-client communications, and the strict ethical obligations of confidentiality in effect in all disciplinary jurisdictions in the United States, clients are allowed and encouraged to be completely candid with counsel. This protection allows lawyers, among other things, to probe the veracity of the statements their clients propose to make in offering securities to the public, and to give frank advice as to the legality and wisdom of their course of conduct. While, in some circumstances, protecting communications between lawyer and client may in an objective sense hinder the search for truth, society has long been comfortable with the judgment that this "impairment is outweighed by the social and moral values of confidential consultations. The [attorney-client] privilege provides a zone of privacy within which a client may more effectively exercise the full autonomy that the law and legal institutions allow."[1]

Unfortunately, the moral laxity of the late 1990s, during which even the President of the United States was able to get away with outright lying to the American people, helped create an environment in which perhaps even securities issuers believed it was acceptable behavior to play fast and loose with the truth. In an era characterized by hypertechnical parsing of language (a debate concerning the definition of "is" being the archetype), it should have come as no surprise that those accessing the capital markets, driven by a self-indulgent culture and a single-minded desire to increase earnings no matter the moral cost, would find creative ways to characterize transactions and enhance the appearance of their financial positions. After Enron, Worldcom and other high-flying corporations deconstructed before our eyes, we saw our lawmakers engage in their favorite pastime: finding someone to blame.[2] Inevitably, fingers began to point to the professionals serving these collapsed entities, most notably their auditors (whose job it is to detect and report fraudulent activities by their clients), but also including their lawyers.

And so it has become fashionable in recent months to propose that the attorney-client relationship be revamped by mandating conduct by lawyers that could lead to wholesale revelations of previously protected attorney-client communications and of legal advice ostensibly given in confidence. These requirements would undoubtedly diminish the willingness of securities issuers to seek and obtain effective legal advice at the time they need it most. The attorney conduct regulations proposed in November 2002 by the Securities and Exchange Commission,[3] for example, are a dangerous step in this direction.

Just as dangerous is the proposition that lawyers should become guarantors of the veracity of their client's statements to the public. A majority of the Supreme Court rejected this concept in its 1994 decision in *Central Bank*,[4] ruling that liability under section 10(b) of the Securities Exchange Act of 1934[5] could not be imposed on mere aiders and abettors: "the statute prohibits only the *making* of a material misstatement (or omission) or the commission of a manipulative act."[6] In the time since the *Central Bank* decision was handed down, most courts in cases involving section 10(b) claims against professionals have confirmed that such claims can be asserted only against a person who has actually made the statement that is challenged as materially false or misleading. As the law has evolved, the fact that a professional helped a client draft its public statements, standing alone, does not render that professional liable as a primary violator of the securities laws.[7]

This approach is consistent with section 11 of the Securities Act of 1933, which considers registration statements to be the responsibility of the issuer of the securities and the issuer's directors who are signatories of a registration statement. Liability is imposed upon those "experts" (like accountants or lawyers) who expressly consent to being "named as having prepared or certified any part of the registration statement, or as having prepared or certified any report or valuation which is used in connection with the registration statement," and then only "with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by" the expert.[8]

The recent corporate scandals have resulted not only in a shift in legislative and regulatory attitudes, but in a recent judicial decision that significantly muddies the waters of professional liability for section 10(b) violations. Addressing various motions to dismiss made by professionals and others in *In re Enron Corp. Securities Derivative & ERISA Litig.*,[9] District Judge Melinda F. Harmon accepted the test urged by the SEC and ruled that under *Central Bank* a professional may be held liable under section 10(b) if with the requisite scienter they "create" a misrepresentation on which investor-plaintiffs rely. Thus, "a person can be a primary violator if her or she writes misrepresentations for inclusion in a document to be given to investors, even if the idea for those misrepresentations came from someone else." [10]

This dangerous and misguided effort to impose liability on lawyers for the wrongdoing of their clients is reminiscent of the age-old tale of the gentleman who lost his keys in an alleyway one night and was seen looking for them a half-block away under a streetlamp. When asked why he wasn't searching in the alleyway, where the keys had undoubtedly been dropped, he explained, "The light is better

out here." Lawyers are prominent participants in the securities industry. This may well make them attractive targets for those seeking to allocate blame, but we should resist the temptation to look where the light may be best. Our society recognizes that even its most reprehensible members — the serial snipers, the child molesters — are entitled to the advice of competent counsel. We have historically stretched our Constitution to and beyond its limits to secure that right. Corporate America is at least entitled to the same treatment. Threatening lawyers with joint and several liability if they do not ensure the truthfulness of all statements made by their clients in offering securities to the public would pit attorney and client against one another as adversaries. Whatever the solution to the perceived dishonesty of public companies may be, it does not lie in depriving them of the right to counsel, or in corrupting the essential nature of the practice of law.

* Steven C. Krane is a Partner, Litigation & Dispute Resolution Department, Proskauer Rose LLP, New York, New York; and Immediate Past President, New York State Bar Association.

Footnotes

[1] American Law Institute, *Restatement of the Law Governing Lawyers*, § 68 cmt. c, at 520 (2000).

[2] Few have heeded the sage words of the character Louis Degas in the film *Papillon* (1973), who remarked: "Blame is for God and small children."

[3] Securities and Exchange Commission, Proposed Rule: Implementation of Standards of Professional Conduct for Attorneys, 17 C.F.R. Part 205 (Release Nos. 33-8150; 34-46868; IC-25829; File No. S7-45-02).

[4] *Central Bank of Denver v. First Interstate Bank of Denver,* 511 U.S. 164 (1994).

[5] 15 U.S.C. § 78j(b).

[6] *Central Bank,* 511 U.S. at 177 (emphasis supplied).

[7] *See Ziemba v. Cascade Int'l, Inc.,* 256 F.3d 194, 1205-07 (11th Cir. 2001); *Wright v. Ernst & Young LLP*, 152 F.3d 169, 175 (2d Cir. 1998), *cert. denied*, 525 U.S. 1104 (1999); *Shapiro v. Cantor*, 123 F.3d 717, 720 (2d Cir. 1997); *Anixter v. Home-Stake Production Co*., 77 F.3d 1215, 1225-27 (10th Cir. 1996); *In re JWP Inc. Securities Litigation*, 928 F. Supp. 1239, 1255-56 (S.D.N.Y. 1996); *In re MTC Electronic Technologies Shareholders Litigation*, 898 F. Supp. 974, 987-88 (E.D.N.Y. 1995); *Vosgerichian v. Commodore Int'l*, 862 F. Supp. 1371, 1378 (E.D. Pa. 1994); *In re Kendall Square Research Corp. Securities Litigation*, 868 F. Supp. 26, 28 & n.1 (D. Mass. 1994).

[8] 15 U.S.C. § 77k(a)(4); cf. *Cashman v. Coopers & Lybrand*, 877 F. Supp. 425, 430 (N.D. Ill. 1995) (sustaining section 10(b) claims against auditors based on alleged misstatements in the "expertising" section of the prospectus); *Austin v. Baer, Marks & Upham*, [1986-87 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 92,881 at 94,277 (D. Or. 1986) (law firm consented to being named in the registration statement as having prepared the legal opinion on the validity of partnership units under state law). A registration statement is not "'expertised' merely because some lawyer prepared it . . . ." *Escott v. BarChris Constr. Corp*., 283 F. Supp. 643, 683 (S.D.N.Y. 1968).

[9] 2002 WL 31854963 (S.D. Tex. Dec. 20, 2002).

[10] Id. (text following note 27) (quoting SEC *amicus curiae* brief).

The ABA's Attack on "Unauthorized" Practice of Law and Consumer Choice

*By George W. C. McCarter**

Judge Posner is not alone in observing that the legal profession is "a cartel of providers of services relating to society's laws" and that restricting entry is the focus of that cartel. Modern economists call it "rent seeking", but throughout recorded history, skilled crafts and professions have tried to raise their members' incomes by using the power of the state to limit entry. The organized bar's preferred method is Unauthorized Practice of Law (UPL) statutes, which generally criminalize the provision of legal services by non-lawyers. For example, in my state of New Jersey, it is a "disorderly persons offense" knowingly to engage in the unauthorized practice of law, and a "crime in the fourth degree" to commit UPL if one (a) creates a false impression that one is a lawyer; (b) derives a benefit from UPL, or (c) causes an injury by UPL. See N.J.S A. 2C:21-22. But state rules vary widely, and Arizona has no rule at all. With accountants at one end and paralegals at the other poaching on traditional legal ground, sentiment has grown within the bar to adopt a consistent and, implicitly, broad definition of the practice of law. Thus when the American Bar Association announced its intention to draft a model Unauthorized Practice of Law statute, few observers, inside or outside the profession, expected this project to open the practice of law to lay competition and wider consumer choice.

The model statute arrived at by the ABA's Task Force on the Model Definition of the Practice of Law provides as follows:

> (a) The practice of law shall be performed only by those authorized by the highest court of this jurisdiction.
>
> (b) Definitions:
>
> (1) The "practice of law" is the application of legal principles and judgment with regard to the circumstances or objectives of a person that require the knowledge and skill of a person trained in the law.
>
> (2) "Person" includes the plural as well as the singular and denotes an individual or any legal or commercial entity.
>
> (3) "Adjudicative body" includes a court, a mediator, an arbitrator or a legislative body, administrative agency or other body acting in an adjudicative capacity. A legislative body, administrative agency or other body acts in an adjudicative capacity when a neutral official, after the presentation of evidence or legal argument by a party or parties, will render a binding legal judgment directly affecting a party's interests in a particular matter.
>
> (c) A person is presumed to be practicing law when engaging in any of the following conduct on behalf of another:
>
> (1) Giving advice or counsel to persons as to their legal rights or responsibilities or to those of others;
>
> (2) Selecting, drafting, or completing legal documents or agreements that affect the legal rights of a person;
>
> (3) Representing a person before an adjudicative body, including, but not limited to, preparing or filing documents or conducting discovery; or
>
> (4) Negotiating legal rights or responsibilities on behalf of a person.
>
> (d) Exceptions and exclusions: Whether or not they constitute the practice of law, the following are permitted :
>
> (1) Practicing law authorized by a limited license to practice;
>
> (2) Pro se representation;
>
> (3) Serving as a mediator, arbitrator, conciliator or facilitator; and
>
> (4) Providing services under the supervision of a lawyer in compliance with the Rules of Professional Conduct.
>
> (e) Any person engaged in the practice of law shall be held to the same standard of care and duty of loyalty to the client independent of whether the person is authorized to practice law in this jurisdiction. With regard to the exceptions and exclusions listed in paragraph (d), if the person providing the services is a nonlawyer, the person shall disclose that fact in writing. In the case of an entity engaged in the practice of law, the liability of the entity is unlimited and the liability of its constituent members is limited to those persons participating in such conduct and those persons who had knowledge of the conduct and failed to take remedial action immediately upon discovery of same.
>
> (f) If a person who is not authorized to practice law is engaged in the practice of law, that person shall be subject to the civil and criminal penalties of this jurisdiction.

The troublesome section is "c", which sets forth a series of broad presumptions. The Task Force has not indicated whether these presumptions are rebuttable, and, if so, how. Logic suggests they may be rebutted by showing that the activity "presumed" to constitute UPL nonetheless does not meet the definition stated in paragraph "b", in particular that it does not require "the knowledge and skill of a person trained in the law". But what does "trained in the law" mean? Three years in law school, a constitutional law course at college, or business law at a vocational school? Use of the definite article "*the* law", rather than "law", implies that the definition includes only a Juris Doctor degree. Since every state but California requires a law degree for bar admission, the Task Force probably assumed that requirement into the definition without expressly stating it.

The model definition does not require that a person be compensated in order to commit UPL. In New Jersey, both lay and lawyer veterans of traffic court know you never plead guilty to a speeding charge, but always negotiate with the prosecutor to plead down to a lesser offense. If one lay person gives this advice to another, is that UPL? Surely not, because such street wisdom does not "require the knowledge and skill of a person trained in the law."

What about drafting an "I love you will" (entire estate to surviving spouse, or to descendants by stocks if none)? Explaining that concept to a lay person takes less than five minutes; training in the law is not required for comprehension. Anyone who sets up shop to draft simple wills without a law license may run afoul of the "presumption" in c(2), but can he point to the basic definition to rebut the presumption? To say that "legal training" may be required to know when a simple will is inappropriate is unpersuasive. Drafting QTIP and credit shelter trusts may require "training in the law", but knowing when they are called for does not. Accountants and financial planners spot this issue all the time.

If the definitional language in paragraph "b" is interpreted liberally as a way to rebut the presumptions in "c", the Model Definition may prove to be fairly harmless. But few commentators expect that result, and the Justice Department and Federal Trade Commission were sufficiently troubled by the Model Definition to submit written objections to the ABA in late December. "Those who would not pay for a lawyer would be forced to do so. And traditionally, lawyers charge more than lay providers for such services. Without competition from nonlawyers, lawyers' fees are likely to increase," said Hewitt Pate, acting assistant attorney general for antitrust, as reported by the A.P. on December 27, 2002.

It is not just the Bush Administration's DOJ that has taken this pro-consumer stance. Even the notoriously lawyer-friendly Clinton Administration objected to broad state definitions of UPL. In 1997, for example, Janet Reno's DOJ opposed an opinion by the Kentucky Bar Association that would have prohibited lay persons from closing real estate transactions. In a letter signed by Assistant Attorney General Joel Klein, the Department argued that "Ending competition from [lay] services is likely to hurt Kentuckians by raising their closing costs and has not been justified as necessary to protect consumers."

The lack of justification noted by AAG Klein has been a consistent hallmark of UPL rules, and the ABA's foray into this area is no different. Although the ABA launched its Task Force with the predictable claim that "[t]he primary consideration in defining the practice of law is the protection of the public," it made no effort to support that conclusion with facts. If protecting the public is the ABA's "primary consideration", the question arises: protection from what? From inept charlatans masquerading as experienced practitioners is what the ABA would have us assume. But what about protection from an exclusive trade guild licensed to charge monopoly prices for even routine clerical services? While both problems may exist in the real world, few readers will infer that the second category was high on the Task Force's agenda.

The ABA's "Challenge Statement" to the Task Force noted that "the ABA has adopted numerous policies over the years that have been fundamentally related to and dependent upon the definition of the practice of law without ever adopting such a definition." Apparently, then, until recently the public has not needed the "protection" of an ABA sanctioned model definition. But the "Challenge Statement" refers to "an increasing number of situations where nonlawyers are providing services that are difficult to categorize under current statutes and case law as being, or not being, the delivery of legal services." The sudden need for a uniform definition is not because the states have run amok with regulations restricting the powers of realtors, paralegals, and adjusters to complete simple transactions without the help of a three digit hourly rate. The only "problem" that the ABA cited in support of this project is "spotty enforcement of unauthorized practice of law statutes across the nation and arguably an increasing number of attendant problems related to the delivery of services by nonlawyers."

No state has ever enforced its UPL rule by forcing a client to hire a paralegal. If the states now tolerate "spotty enforcement", then the "un-spotty" enforcement the ABA has in mind must be intended to put many paralegals and others out of business. But the ABA has told us its primary concern is protecting the public. If so, the restriction on consumer choice it seeks must be necessary to protect a vital public interest. Let's look again at the ABA's explication of the alleged problem, as quoted in the previous paragraph: "*arguably* an increasing number of attendant problems related to the delivery of services by nonlawyers" (emphasis added).

When a lawyer describes a proposition as "arguable," he is either belittling it (that point is at best arguable), or he is contending desperately to keep it alive (my point is surely at least arguable, your Honor). A merely "arguable" point is probably not very persuasive, and it must have been an institutional Freudian slip that caused the ABA to use that word to describe the supposed problems arising from the delivery of quasi-legal services by nonlawyers. The ABA may have "argument" to support the need for a broad UPL statute to protect the public. It needs evidence and should present it.

Given that its primary constituency is lawyers, the ABA Task Force may have assumed it didn't really need to demonstrate a "problem", since the problem of concern to the profession (lay competition) was obvious. But scholars who have examined the data have consistently found no genuine threat to the public from lay provision of legal services. Professor Deborah Rhode of Stanford University, for example, did a study in 1981 entitled "Policing the Professional Monopoly: A Constitutional and Empirical Analysis of Unauthorized Practice Prohibitions," 34 Stanford Law Review 1 (1981). She reported that "Although the organized bar has often suggested that the campaign against lay practice arose as a result of a public demand, the consensus among historians is to the contrary." Her analysis found that of all incidents of UPL in 1979, only two percent were consumer complaints that involved actual damage.

More recently, in 2002 the Arizona Chapter of the Institute for Justice submitted comments in opposition to a proposed rule in that state that would bar anyone but a lawyer from "[p]reparing any document in any medium intended to affect or secure legal rights for a specific person or entity." The Arizona Bar claimed it had "received four hundred com-

plaints alleging that 'non-lawyers' were practicing law in Arizona." IJ did its own research and found the following:

Out of the 378[1] complaints (not 400) filed with the State Bar we discovered that:

- 123 were nothing more than copies of advertisements, including 48 one-page flyers for estate seminars.
- 38 of the flyers were submitted by a single lawyer who practices estate law.
- Ten of the flyers were collected by the Bar's UPL lawyer and her husband.
- 80 complaints were made anonymously; 50 of the anonymous complaints were advertisements.
- 26 complaints were against licensed attorneys.
- 24 were complaints against 13 disbarred lawyers, the most troublesome complaints being against disbarred Arizona lawyers already under this Court's jurisdiction.
- 20 were complaints against out-of-state lawyers practicing without membership in the Arizona Bar.
- Seven complaints against independent paralegals/ document preparers were filed by third-parties who thought the work being performed sounded like the practice of law.
- 25 complaints were against eight individuals whose conduct clearly constituted criminal behavior under current law (in fact, the Bar's UPL lawyer informed us during our review that several of the respondents had already served time in jail for fraudulent behavior).
- 14 complaints of UPL were filed by State Bar personnel or their spouses.
- 74 of the complaints were filed by lawyers.
- At least 32 complaints were against public adjusters, who may fall under the jurisdiction of the Arizona Department of Insurance.
- *Only 11 complaints were filed by a consumer against independent paralegals/document preparers*.

Emphasis in original. Consumers generally have enough sense to figure out for themselves when they do and when they don't need a lawyer. If the ABA were truly interested in a pro-consumer definition of UPL, and one that has the great benefit of simplicity, it could adopt the definition proposed by HALT, an organization advocating legal reform: "The unauthorized practice of law means saying you are a lawyer when you are not." But the ABA, like so many lawyers, has little affinity for simplicity.

The "problem" that broad UPL rules are intended to address is reminiscent of the "problem" said to be solved by mandatory continuing legal education (CLE) rules. I have never heard of a study showing that lawyers in mandatory CLE jurisdictions are more competent, or serve the public better, than elsewhere, but that has not stopped numerous state bar associations from ramming mandatory CLE down their members' throats. Because "continuing education" sounds like such a good idea, making it mandatory must be better. Because "unauthorized practice" sounds like a bad thing, outlawing it broadly must be in the public interest. Thus, the ABA even concludes its "Challenge Statement" by predicting, without a hint of irony, that the model definition would "support the goal to provide the public with better access to legal services, be in concert with governmental concerns about anticompetitive restraints, and provide a basis for effective enforcement of unauthorized practice of law statutes." Now that the Task Force has produced its Model Definition, the kindest observation might be that a .333 average is not bad in baseball.

* George W. C. McCarter is an attorney with McCarter & Higgins, Shewsbury, N.J. and a past Chair of the Professional Responsibility Practice Group.

Footnotes

[1] Because an individual complaint may fall into more than one category the total number of complaints discussed will not add up to 378.

Religious Liberties

Faith, Funds, and Freedom:

Restoring Religious Liberties for CARE Act Employers

*by James A. Sonne**

Introduction to a Charitable Dilemma

It is no secret that President Bush has made it a priority of his administration to increase the role of faith-based institutions in meeting the social service needs of the nation.[1] The major questions for such entities, however, are: 1) how much of a role will they play, and 2) what demands, if any, will be placed upon their beliefs in the process. The answer to the first question is that they have been offered a rather large role, whether one looks at the President's proposals or those in Congress, all of which provide potentially billions of dollars for charitable work.[2] The answer to the next question, though, is less clear. Certainly, President Bush has made efforts to reassure faith-based groups.[3] Yet, based on the latest Senate proposal,[4] which apart from more limited efforts presently underway (including executive orders)[5] reflects the most likely form the project will ultimately take, there is reason for these groups to hesitate. Indeed, such hesitation is particularly warranted in light of the proposal's potential impact on the ability of faith-based entities to make employment decisions in accord with their religious beliefs. Upon further reflection, however, there may be cause for hope - at least on some level.

CARE Act Challenges

In the most recent Congress, a bipartisan coalition of members of the United States Senate introduced the Charity Aid, Recovery, and Empowerment Act of 2002 (the "CARE Act" or "Act").[6] The CARE Act is a response to proposals by the President and legislation passed by the House of Representatives for expanding the role of faith-based institutions in providing secular social services such as child protection, drug and alcohol treatment, crime prevention, job training, hunger relief, assistance for unwed mothers, and care for the elderly.[7] Although the Act stalled at the close of last year's session, it is probably safe to say that, apart from the more limited executive orders and select programs mentioned above, its approach has the highest chance of success in guiding the course for faith-based and community initiatives through the new Congress, particularly as such initiatives affect the employment practices of participating service providers.[8]

The CARE Act provides many of the same resources as its executive and House counterpart proposals, including billions of dollars in tax incentives and assistance for needy families.[9] The Act also expands existing social service block grants and offers administrative assistance to smaller community organizations.[10] In its treatment of access for religious entities to these and other federal programs, however, the CARE Act differs significantly from its predecessors. The Act does protect religious symbols, names, and governance, and forbids rejecting a participant simply because it has "not previously been awarded" participation, which would, of course, include any such prior religious-based rejection.[11] However, as is most relevant for our present purposes, it may restrict the exercise by a participating religious organization of its beliefs when making relevant employment decisions.[12]

Admittedly, the Act does not explicitly revoke the exemptions from applicable discrimination laws that are otherwise available to religious employers, perhaps in an effort to avoid the issue altogether.[13] Yet, express revocation may come with the new Congress, particularly given the related grounds offered by those who opposed the Act in November 2002;[14] and, even if it does not, the Act still poses significant risks to these entities by failing to offer categorical protection. As Senator Santorum, one of its co-sponsors, concedes, "[w]e are not discriminating in the hiring" under the Act.[15] If the exemptions are left untouched, the harm may be limited, but given the lack of certainty on this, as well as the differences from the House bill (which expressly protected the exemptions)[16] and the implications from discrimination prohibitions already in effect for the delivery of services under certain other federal programs,[17] there are no guarantees.

In failing to safeguard the exemptions that faith-based employers presently enjoy or otherwise invoke "charitable choice" (which is the name given to these and other rights afforded to such groups under relevant federal programs), the Act may, contrary to the wishes of the President and the House, require them to "check their beliefs at the soup kitchen door." In its current form, the Act would place these employers in the unenviable position of choosing between, on the one hand, the risk of forfeiting the presently-protected religious liberty of mission-based employee selection and retention and, on the other, bearing the inevitable burdens (litigation or otherwise) of its continued pursuit in the face of silence. If the Act was amended and the revocation made express, such challenges, whether philosophical, legal, or practical, would naturally be even greater.

Imagine a Jewish shelter for abused women, a Muslim inner-city youth center, or a Christian hospice for the aged. Presumably, anyone familiar with the services provided at each of these places would conclude that such services are otherwise non-religious in nature and that they contribute to the public welfare, notwithstanding the motivations of their providers, which almost certainly include the idea that religious beliefs enhance the service to be provided. Yet, if these beliefs include ideas such as "hiring co-religionists produces a better or more authentic service," these pro-

viders may be prohibited from participating under the Act, regardless of the loss to the public or the chilling effect on religion in general. In fact, on this latter point, it would seem to be a necessary inference that the more seriously one takes religion, the greater this risk of being excluded. Thus, in a sense, the very content of belief may become the issue in determining access to an otherwise available program to provide otherwise valuable secular services. Among the dilemmas facing potential faith-based participants, this may be their most disconcerting.

RFRA Rays of Hope

Despite the risks to faith-based entities posed by the CARE Act approach, either in its present silence or through any express revocation of discrimination law exemptions, there may be a possible, if limited, savior in the Religious Freedom Restoration Act of 1993 ("RFRA").[18] Congress adopted RFRA in reaction to the 1990 decision by the Supreme Court in *Employment Division v. Smith*, which held that there is no "free exercise of religion" right under the First Amendment of the United States Constitution[19] to be excused from obeying neutral laws of general application (in that case, the violation of a state narcotics law in the religious use of peyote which resulted in the denial of unemployment compensation).[20] In response, RFRA provides that government cannot simply rely on a law's neutrality to religion, but must demonstrate a "compelling interest" for any "substantial burden" to "religious exercise" that may result from its enactment or enforcement, something that may prove rather difficult for it to demonstrate in regulating the heretofore-protected employment policies of providers in the faith-based initiative.[21]

RFRA suffered a tremendous blow in the Court's 1997 decision of *City of Boerne v. Flores*,[22] which held that in adopting the measure Congress overstepped its authority in protecting civil rights under the Fourteenth Amendment of the Constitution.[23] That case, however, involved the application of RFRA to state, not federal, law. Indeed, a fair reading of *Flores*, together with a consideration of relevant lower court rulings,[24] suggests that RFRA still applies to federal law. Thus, RFRA could quite possibly provide protection from at least *federal* discrimination laws by insulating faith-based entities regardless of what such laws otherwise provide. This certainly would go a long way in addressing the concerns of faith-based participants in the CARE Act or, for that matter, any other federal program.

RFRA, however, is by no means a panacea for faith-based entities. Indeed, as far as state and local discrimination laws are concerned, *Smith* still poses a significant hurdle, except to the extent such states or localities have their own religious entity exemptions or their own RFRA-like statutes, either of which many states do,[25] and to the extent certain narrowly confined positions, like a priest, minister, imam, or rabbi, are otherwise insulated by the First Amendment (the "ministerial" exemption).[26] Of course, apart from any preemptive exemption of state or local law, something which was arguably included in House versions of the Act[27] but does not even exist under current federal law[28] (and may face some difficulty under *Flores* even if it did), faith-based entities would be no worse off than they are today in having to obey (or not) such state or local laws.

Perhaps a greater challenge to using RFRA in the CARE Act context, though, is less of a legal problem and more of a practical problem - namely, to obtain protection under RFRA, each faith-based provider would have to prove that it is covered by RFRA's terms. Thus, the price for each entity would certainly be higher than a blanket statutory protection given the burden to prove coverage on a case-by-case basis. Under RFRA, each provider would need to demonstrate why the CARE Act "substantially burdens" it in its "religious exercise," rather than merely showing that it is a religious entity. The former will surely not be as simple as the latter.

Notwithstanding the challenges to religious entities that may arise, however, by offering protection on the federal level RFRA provides significant solace in what might otherwise be a necessary political compromise to further the faith-based initiative project. State and local law may still apply, and certainly the litigation burdens on these entities will not be insignificant. Yet, in the face of opposition to categorical exemptions within the Act or through some other alternative such as "charitable choice," RFRA, and its attendant popularity in Congress (e.g., it passed almost unanimously),[29] may provide the best protection available. Of course, this assumes that such entities would otherwise elect to provide services under the Act, which is an issue outside the scope of this article.

Relevant Exemptions from Employment Discrimination Law

Exemptions from employment discrimination laws for religious entities, whether statutory, constitutional, or common law, are rooted in a theory of church-state relations providing that government should not involve itself in the internal affairs of religious institutions. Furthermore, under this theory, the more central the job or position in question is to a religion, the greater the reluctance to regulate. In any event, the overall purpose of these exemptions is to limit "governmental interference with the ability of religious organizations to define and carry out their religious missions."[30]

Federal Law

The general federal prohibition of discrimination in employment is found in Title VII of the Civil Rights Act of 1964, which provides, in pertinent part, that:

> [i]t shall be an unlawful employment practice for an employer . . . to fail or refuse to hire or to discharge any individual, or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, because of such individual's race, color, religion, sex, or national origin . . . .[31]

In the face of this general pronouncement, however, there are statutory and constitutional "exemptions to the rule" for certain "religious" employers.

On a statutory level, there are three exemptions to the general prohibition against discrimination: 1) religious corporations, associations, or societies, 2) religious schools, and 3) religion as a "bona fide occupational qualification." The first 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 [entity] of its activities."[32] The second states that "it shall not be an unlawful employment practice" for an educational institution "to hire and employ employees of a particular religion if [it] is, in whole or substantial part, owned, supported, controlled, or managed by a particular religion or by a particular religious [entity] or if [its] curriculum is directed toward the propagation of a particular religion."[33] Both of these first two exemptions offer blanket protection from religious discrimination claims (but not others - e.g., race, sex) based on the nature of the employer - for example, dioceses, temples, or mosques, and, depending on their connection, related entities such as hospitals, shelters, and, in particular, schools. These exemptions ensure "that all religious institutions, including all church-affiliated schools, may use religious preferences in making employment decisions."[34] Typically, litigation focuses simply on the nature of the institution and, for the most part, such determinations are easily made.[35]

The third statutory exemption provides even more generally that "it shall not be an unlawful employment practice" for any employer to "hire and employ employees" on the basis of "religion, sex, or national origin . . . where religion, sex, or national origin is a bona fide occupational qualification reasonably necessary to the normal operation of that particular business or enterprise."[36] Although this provision is available to all employers, not just religious ones, and it extends beyond religion to both gender and national origin, "the Supreme Court has cautioned that this exemption is to be read narrowly" in that "[b]usiness necessity, not convenience or preference, must be proved by the employer."[37] Cases concerning the religious "bona fide occupational qualification" (or BFOQ), which are rather scarce, reflect the narrowness of the exemption.[38] Examples include an otherwise non-exempt college maintaining tradition by reserving positions for Jesuits[39] and an employer in Saudi Arabia restricting helicopter pilot jobs to Muslims.[40]

In addition to statutory exemptions, the United States Constitution, as mentioned above, also provides protection, albeit on a more limited basis. In this regard, the so-called "ministerial" exemption, which is rooted in a non-entanglement view of the First Amendment, insulates churches and other institutions with "pastoral missions" (including groups such as the Salvation Army) from regulation of "ministerial or pastoral duties."[41] As the Fourth Circuit has opined, "[t]his constitutionally compelled limitation on civil authority ensures that no branch of secular government trespasses on the most spiritually intimate grounds of a religious community's existence."[42] Covered employees are those whose "primary duties consist of teaching, spreading the faith, church governance, supervision of a religious order, or supervision or participation in religious ritual and worship."[43] Although the job range is narrow (e.g., rabbi, imam, minister, priest), this exemption extends beyond religion to any other status discrimination. Of course, the fact that CARE Act aid is limited to secular purposes[44] suggests that, in the absence of a "minister" who also provides aided secular functions, the implication of such positions would be limited in any event.[45]

The final "exemption" to federal discrimination law is less of a direct employment law exemption and more of an existing example of what the House bill would provide, namely "charitable choice."[46] Such protection, which is provided under both the Personal Responsibility and Work Reconciliation Act of 1996 (a welfare-reform bill signed by President Clinton that covers a much narrower group of participants than the CARE Act) and a December 2002 order signed by President Bush, allows religious groups to provide charitable services "without impairing the religious character of such organizations."[47] In so doing, the House bill, like the 1996 welfare-reform bill and unlike the CARE Act, also explicitly preserves the Title VII exemptions.[48]

State and Local Law

As mentioned above, Title VII, although the best known, is not the only source of employment discrimination law. Indeed, almost every state (with Alabama, Georgia, and Mississippi being the exceptions)[49] has its own general prohibition of discrimination in private employment.[50] In fact, even some cities have their own such laws.[51] Although these laws often merely supplement Title VII (which applies only to those with 15 or more employees)[52] by extending its prohibitions to smaller employers,[53] they often have different applications and exemptions[54] and, thus, must be reckoned with in their own right.[55] Moreover, in aid situations where the state plays an active role, challenges may also arise under the discrimination provisions of relevant "public contractor" statutes.[56]

State discrimination law exemptions vary.[57] Although a majority of states provide both a "bona fide occupational qualification" exemption and an exemption to religious entities (or schools) for religious purposes, some provide one, some the other, and some neither.[58] As far as the "ministerial" exemption to such state laws is concerned, this exemption would apply as a matter of federal constitutional law in the same manner as under Title VII, in addition to any further "free exercise" or "establishment" applications under analogous state constitutional provisions.[59] Finally, a few states have adopted their own "religious freedom restoration" statutes, which, in the absence of state constitutional conflicts, would apply to state discrimination laws.[60]

The Impact of the CARE Act on the Exemptions

Although the House version of the faith-based initiative addresses the exemption issue directly in generally guaranteeing continued protection to religious entities in the employment arena, the Senate's CARE Act is virtually silent

on the matter. As a result, religious groups may face significant risks under the Act when seeking to participate in a manner consistent with their beliefs, at least upon review of the face of this legislation.

The House version, which is entitled the "Community Solutions Act of 2001," provides tax incentives for charitable contributions, expands the ability of faith-based organizations to provide secular services, and offers assistance to low-income families.[61] In so doing, it also addresses participation by religious entities in numerous ways. These include non-discrimination against providers or beneficiaries, secular use limitations, and character and autonomy protections, including internal governance and symbols of religious character.[62] More pertinently, the bill provides that "a religious organization's exemption" under Title VII (i.e., organizational, not necessarily educational or BFOQ) "regarding employment practices shall not be affected by its participation in, or receipt of funds from" programs under the bill.[63] By this provision, the House version expressly protects the first federal statutory exemption described above and, thus, a covered group would not be required to forfeit its right to maintain a workforce that reflected its beliefs in exchange for participation. The bill does not otherwise expressly address the other statutory or constitutional exemptions to discrimination laws, federal or state.

The Senate's CARE Act provides charitable incentives similar to the House bill, including the expansion of tax benefits for charitable giving and avenues for increased partnership between government and faith-based entities, but it addresses the rights (and/or duties) of participating entities in a much more limited fashion.[64] In this respect, the Act merely provides that a participating organization shall not be made to alter or remove religious symbols, otherwise permissible governing documents, or board membership standards, and that it shall not be denied participation based on any previous rejection.[65] Yet, as the Act's overview provides, it does "not relieve any applicant from meeting all other grant criteria or address the issues of preemption of civil rights laws."[66] Thus, the Act, apart from removing the express protections of the House version, offers no alternative statement concerning the continued viability of relevant exemptions under federal or state employment discrimination law. Senator Lieberman, a chief sponsor of the Act, stated that the employment discrimination issue "is not specifically within the parameters of this proposal" and that it "is an issue for another day."[67]

Given the relative silence of the CARE Act, therefore, it is unclear which, if any, discrimination exemptions would be at risk. Certainly, it appears that the "ministerial" exemption, if it applies, would survive due to its existence outside the Title VII context through notions of church autonomy and its heightened constitutional status.[68] Indeed, every court that has discussed this exemption in light of *Smith* has upheld it,[69] and, based on the strong language used by such courts in so doing (e.g., "a constitutional command cannot yield to even the noblest and most exigent of statutory mandates"),[70] there is no indication that the provision of relevant CARE Act aid would alter this analysis.

Notwithstanding the continued viability of the "ministerial" exemption, however, the remaining Title VII exemptions (i.e., organizational, educational, BFOQ), would be vulnerable in the absence of protections similar to the "charitable choice" provision of the 1996 welfare package or the House version of the bill. Indeed, Senator Lieberman confessed as much when he stated that the Act "contains none of the troubling charitable choice provisions that were in the House bill, H.R. 7, that undermined or preempted civil rights laws and raised constitutional concerns."[71] Thus, as the House bill implies, in the absence of express protection, religious groups will essentially be on their own in protecting their rights to be free from interference, either in the defense of discrimination suits brought in light of Act participation or in response to denials by the government of such participation based on restrictions otherwise applicable to existing programs set to be expanded by the Act. This would certainly have a chilling effect on the willingness of such groups to either exercise rights under current law or participate in Act objectives, and, obviously, any further express revocation would only deepen the freeze.

As far as state law is concerned, it is unlikely that the Act would have much of an impact one way or another. Neither the House version nor the CARE Act itself expressly addresses state law. In fact, the CARE Act overview explicitly disavows "preemption."[72] Indeed, in light of *Flores*, which limited the authority of Congress in "carving out" exceptions to neutral and generally applicable state laws to cases where a history of discrimination is addressed,[73] it is doubtful that the Act could preserve or discard such exemptions even it wanted to do so. Furthermore, some of the aid provided by the Act flows only to "community-based organizations" (defined as those having "not more than 6 full-time equivalent employees who are engaged in the provision of social services"),[74] which would most likely expose these groups only to state or local discrimination laws, if any, given that Title VII requires at least 15 employees for coverage.[75]

Based on the foregoing, religious entities are presented with a serious dilemma that seems to require them to bear the burden of preserving existing exemptions in the face of challenges either from employees (future or current) in the form of discrimination claims or, perhaps down the line, from agencies refusing to grant Act aid on a similar basis. Such challenges would be even greater if a further amendment expressly revokes the exemptions. As mentioned above, in seeking relief from this predicament, however, RFRA may offer some relief. Thus, it is to that law that we must now turn.

The "Trinity"(*Smith*, RFRA, and *Flores*) and Beyond

The RFRA story begins in 1990 with the Court's *Smith* decision.[76] As mentioned above, *Smith* involved a constitutional challenge under the federal Free Exercise Clause to Oregon's denial of unemployment benefits based on violations of its drug laws. The challengers argued that the violation, smoking peyote, was a religious practice and, thus, its proscription must be supported by "a compelling state interest," something which they said was absent. They based

their claim on *Sherbert v. Verner*,[77] which involved the denial of unemployment benefits for not working the Sabbath, and *Wisconsin v. Yoder*,[78] which involved compulsory schooling, where the Court had applied this strict standard to burdens on religion. The Court in *Smith*, however, rejected heightened scrutiny, holding that "the right of free exercise does not relieve an individual of the obligation to comply with a 'valid and neutral law of general applicability.'"[79] According to the Court, as long as a law does not target religion, the Free Exercise Clause offers no exemption beyond what a state might wish to adopt. Interestingly, the Court distinguished cases involving a "hybrid" of free exercise and other constitutional rights (which may require exemption).[80] The Court indicated further that such a hybrid may be formed from "controversies over religious authority or dogma,"[81] - a strong sign of continued support for a "ministerial" exemption, whether on association or entanglement (i.e., establishment)[82] grounds.

The Congressional response to *Smith* was rapid and overwhelmingly negative. In 1993, RFRA passed "almost without opposition."[83] In its findings, RFRA expressly criticizes the holding in *Smith* and asserts that its purpose is "to restore the compelling interest test as set forth in [*Sherbert*] and [*Yoder*] and to guarantee its application in all cases where free exercise of religion is substantially burdened."[84] In pursuing this objective, RFRA provides that "[g]overnment shall not substantially burden a person's exercise of religion even if the burden results from a rule of general applicability" unless the burden "is in furtherance of a compelling governmental interest [and] is the least restrictive means of furthering that compelling governmental interest."[85]

From the language of RFRA (and pre-*Smith* jurisprudence), one discerns a three-part test. First, a party seeking RFRA protection must show a substantial burden to a religious exercise. This exercise must be "motivated" (not necessarily compelled) by a "sincerely held" religious (not merely philosophical) belief,[86] and the burden imposed must "significantly inhibit or constrain" the exercise.[87] Current examples of exercise include tithing, worship, grooming, and, in the employment context, selecting ministers,[88] while substantial burdens range from conditioning a "benefit or privilege" to outright prohibition.[89] Second, if a burden is imposed, the government must have a "compelling interest." Examples include health and safety, prison security, environmental concerns, and, perhaps, compliance with the Establishment Clause (the "other half" of the First Amendment's treatment of religion).[90] Finally, if a burden is imposed for a compelling interest, it must be the least religiously invasive alternative in serving that interest. This, of course, would be determined under the circumstances given the options available.

Four years after RFRA's passage, the Court decided *Flores*.[91] That case involved a RFRA challenge to a denial of a building permit to a church under a city ordinance. In rejecting the claim, the Court held RFRA unconstitutional as applied to state or local law. Specifically, the Court stated that the sole source of authority to apply RFRA to such law is the "enforcement clause" of the Fourteenth Amendment, which allows Congress to correct, by "appropriate legislation," state deprivations of "life, liberty, or property, without due process of law."[92] The Court held that RFRA, as applied to states or localities, did not serve to remedy any such deprivations of rights, but rather attempted "a substantive change in constitutional protections" (i.e., "free exercise") and, in so doing, intruded upon the "States' traditional prerogatives and general authority to regulate for the health and welfare of their citizens."[93]

Although the Supreme Court did not address the issue in *Flores*, most lower courts have held that its ruling has no effect on applying RFRA to federal law.[94] As the Ninth Circuit has held, "[c]ourts have interpreted RFRA as an amendment of existing federal statutes and thus a constitutional exercise of Congressional authority."[95] In *Flores*, the Court expressed hostility to what it saw as Congress' attempt to violate the "separation of powers" by amending *Smith*.[96] Yet, it is unlikely that this hostility extends to RFRA for federal law, which is, in essence, only a self-imposed limit on otherwise valid legislative power. As one scholar has noted, Congress has simply "denied itself the option of legislating burdens on religious exercise unless it can overcome the extrinsic political inertia imposed by the RFRA."[97] Constitutionally, any facial challenge to RFRA under the Establishment Clause should likewise fail based on its secular purpose ("protect First Amendment values"), limited risk of indoctrination (protection only if "substantial burden" to a valid religious exercise), and avoidance of any religious entanglement.[98]

RFRA and the CARE Act: Obstacles and Opportunities

Based on the foregoing, there is a strong argument for RFRA protection of CARE Act providers under federal law, despite any present or future elimination of Title VII exemptions. If the Act prohibits or, at a minimum, chills the ability of religious charities to discriminate on the basis of religion (or any other basis, for that matter), these groups could invoke RFRA, at least on the federal level. Of course, the Act could be amended to remove RFRA protection, but given the latter's popularity, that seems unlikely. In any event, there remain two major challenges, both of which are rooted in RFRA itself. The first is the argument that elimination of the religious exemptions reflects a "compelling interest" and, thus, even if RFRA applies it offers no "discrimination" relief to Act participants. The second, which does not exist under the categorical approach of Title VII (where one may discriminate because of religion simply because one is a religious entity), is demonstrating that the Act "substantially burdens" the religiously motivated practice of discrimination. As described below, this latter challenge will, at least from a practical perspective, probably prove a greater hurdle than the former.

Compelling Interests?

The "compelling interest" challenge to applying RFRA is the argument that eliminating the exemptions, implicitly or explicitly, meets the standard, notwithstanding the

admonition in *Flores* that "compelling interest," along with the "least restrictive means" requirement, "is the most demanding test known to constitutional law."[99] In support, the "interests" typically offered, and those which should ultimately fail, are eliminating discrimination and avoiding establishment of religion.

The former "compelling interest" argument posits that an end to employment discrimination, particularly if "funded by the government,"[100] is a goal worthy of placing strings on CARE Act aid. The response, however, is that not only do existing exemptions for religious entities reflect the opposite policy judgment, but RFRA itself (reflecting a principle from *Sherbert*) extends protection not simply to laws concerning conduct, but also to denials of "funding, benefits, or exemptions."[101] In fact, in one of the few cases applying RFRA to current exemptions (admittedly there, the constitutional "ministerial" exemption without any funding issues), the D.C. Circuit held that "the Government's interest in eliminating employment discrimination is insufficient to overcome a religious institution's interest in being able to employ the ministers of its choice."[102]

The Establishment Clause "compelling interest" argument, which has been advanced in other contexts by members of both the House and Senate, is that eliminating the relevant exemptions is necessary to avoid a violation of the First Amendment through "public funding" of religion.[103] This is the constitutional challenge to RFRA *as applied* (rather that on its face, as described above). The first response is that the Supreme Court has unanimously upheld existing exemptions under the Establishment Clause,[104] and such exemptions have generally been upheld by lower courts even when coupled with public funds.[105] The second response is that the aid provided through the Act to faith-based groups is valid under relevant Supreme Court jurisprudence, most recently articulated in *Agostini v. Felton* (1997),[106] which approved placing public teachers in parochial schools, in *Mitchell v. Helms* (2000),[107] which approved federal and state educational materials and equipment for "pervasively sectarian" schools, and in *Zelman v. Simmons-Harris* (2002),[108] which authorized religious school participation in a state voucher program.[109]

Although *Zelman* emphasized that voucher aid is ultimately provided to religious entities through the "private choice" of parents[110] and *Mitchell* noted that the aid there was not money but hardware and other materials,[111] these distinctions are not dispositive. First, most of the "aid" ultimately provided to religious entities under the Act comes in the form of tax incentives to individuals, something which is both justified by *Zelman* and expressly authorized by the 1970 case of *Walz v. Tax Commissioner of the City of New York*, where the Court held that "there is no genuine nexus between tax-exemption and establishment of religion."[112] Second, given the secular purpose and religiously neutral nature of any other aid provided under (or contemplated by) the Act, it is unlikely that RFRA alone would upset the balance. Indeed, under *Mitchell*, "indirect" aid (e.g., vouchers, tax exemption) is permissible regardless. Third, even if the aid were "direct" (e.g., a money grant), the religious nature of recipients may be a factor,[113] but it would be this overall nature (a subject outside the scope of this article), not employment policy alone, that would, if at all, render participation suspect.[114]

Finally, although the argument is perhaps weakened by the fact that any relevant discrimination prohibitions under the Act would presumably apply to religious and non-religious entities alike, there may also exist some independent constitutional protection under the Free Exercise or Equal Protection Clauses through the Court's 1995 decision in *Rosenberger v. Rector and Visitors of the University of Virginia*.[115] In that case, the Court struck down a public university's refusal to provide funds to a student magazine under an otherwise available program because of the magazine's religious viewpoint. The *Rosenberger* argument, however, would seem to turn on whether or not religious viewpoints are expressly selected for special treatment, something that is not apparent under the current version of the Act. Nevertheless, it would not be wholly unreasonable for a future Act provider to protest limitations on its ability to adopt religiously motivated employment practices as something which, at least from a practical perspective, targets only those who care about such things - namely, groups with a religious viewpoint.

Substantial Burdens?

The second, and perhaps greater, challenge in applying RFRA to Act participants is the need for each individual entity to show that any relevant prohibition of religious discrimination is, in fact, a substantial burden to a religious exercise. Certainly the most efficient and secure means of guaranteeing relevant exemptions is an express codification in the Act itself - an approach taken by the President and the House.[116] In this way, relevant issues would likely be decided once and for all through appropriate litigation in a manner similar to the Court's handling of existing exemptions in *Amos*. Instead, the approach taken by the Act, implicitly or explicitly, leaves the matter to participants, either in defending discrimination or in challenging a denial of participation, to show RFRA coverage. Admittedly, the burden is not insurmountable. In fact, as the Court in *Smith* posited, "[w]hat principle of law or logic can be brought to bear to contradict a believer's assertion that a particular act is 'central' to his personal faith?"[117] Yet, in any event, the practical price will certainly be higher than at present, and given case-by-case litigation risks, a chilling effect might still prove inevitable.

Where Does RFRA Leave Us?

The CARE Act, either in its present silence or through future amendments that may be necessary for its passage, poses significant risks to employment practices that are presently protected as a matter of religious liberty. Although the "ministerial" exemption should survive, the statutory exemptions are vulnerable. Despite these risks, however, there is a sound argument that RFRA may limit the

exposure, at least on the federal level. Logistical problems for faith-based institutions may remain in proving RFRA coverage, and state and local law may still apply, but RFRA offers much solace to such entities that wish to participate in the Act's effort. Although these groups would surely prefer blanket protections, RFRA should lower the risk that they will need to trade their beliefs to lend a hand. Thus, in this arena, one can safely say that RFRA is "not dead, but sleeping."[118]

Postscript

The Federalist Society first published this article on its website on February 20, 2003. Since then, the Senate approved a narrower version of the CARE Act. This bill (S. 476), which the Senate passed on April 9, 2003, contains many of the same tax incentive, social service grant, low-income, and administrative provisions as its 2002 counterpart. Yet, it lacks even the limited faith-based protections that the former bill provided. These included a protection of symbols, names, and governance, and a prohibition of aid denials based on prior treatment (perhaps on a basis inconsistent with intervening constitutional jurisprudence). In any event, the analysis provided by this article, although it targets an earlier version of the bill, is still both timely and relevant given the silence of both that version and the one that ultimately passed the Senate on the protection of discrimination exemptions for faith-based employers. In fact, it is arguably even more relevant based on the latter's elimination of what little protection the former contained. As President Bush stated upon passage of the 2003 bill, "I look forward to continuing to work with Congress to improve the CARE Act legislation, and I continue to urge Congress to take additional steps to end discrimination against faith-based organizations that have a proven record of helping people in need realize a better life." As one can see, the issue is far from settled.

* James A. Sonne is Assistant Professor of Law, Ave Maria School of Law. B.A. 1994, Duke University; J.D., Harvard Law School.

Footnotes

[1] *See* Establishment of Office of Faith Based and Community Initiatives, Exec. Order No. 13,199, 66 Fed. Reg. 8499 (Jan. 29, 2001). *See also* Jim VandeHei, *GOP Looks To Move Its Social Agenda*, WASH. POST, Nov. 25, 2002, at A01.

[2] Veronique Pluviose-Fenton, *Bush Backs Compromise Faith-Based Initiative*, NATION'S CITIES WEEKLY, Feb. 11, 2002, at 1.

[3] As President Bush stated on April 4, 2002 when discussing relevant legislation, "people should be allowed to access that money without having to lose their mission or change their mission." *President Promotes Faith-Based Initiative,* White House Press Release, (Apr. 4, 2002), at http://www.whitehouse.gov/news/releases/2002/04/20020411-5.html. On December 12, 2002, the President stated, "faith-based programs should not be forced to change their character or compromise their mission." *President Bush Implements Key Elements of his Faith-Based Initiative*, White House Press Release (Dec. 12, 2002), at http://www.whitehouse.gov/news/releases/2002/12/20021212-3.html.

[4] The Charity Aid, Recovery, and Empowerment Act, S. 1924, 107th Cong. (2002).

[5] *See* Responsibilities of the Department of Agriculture and the Agency for International Development with Respect to Faith-Based and Community Initiatives, Exec. Order No. 13280, 67 Fed. Reg. 77,145 (Dec. 12, 2002); Equal Protection of the Laws for Faith-Based and Community Organizations, Exec. Order No. 13279, 67 Fed. Reg. 77,141 (Dec. 12, 2002). Other limited efforts include provisions in the Personal Responsibility and Work Reconciliation Act of 1996, 42 U.S.C. § 604a, the Community Services Block Grant Program of 1998, 42 U.S.C. § 9920, and appropriations for programs for Departments of Justice, Commerce, State, and Health and Human Services (*see generally*, David Ackerman, *Public Aid to Faith-Based Organizations in the 107th Congress (Charitable Choice): Background and Selected Legal Issues*, CRS Report RL31043 (Dec. 3, 2002) at CRS-8-9).

[6] *See* 148 Cong. Rec. S546-01 at S546 (daily ed. Feb. 8, 2002) (statement of Sen. Lieberman). The Act is co-sponsored by Sens. Santorum, Bayh, Brownback, Nelson, Cochran, Carnahan, Lugar, Clinton, and Hatch.

[7] *See* S. 1924 § 301.

[8] *See* Larry Witham, *Amendments Kill CARE in Senate; Democrats Fear Faith-Based Abuses*, WASH. TIMES, Nov. 12, 2002, at A10. As one commentator described the last (107th) Congress, "[g]iven the negative press . . . over the issue and the widespread concern among Senate Democrats about employment discrimination, it is unlikely that this Congress would approve a version that [authorized discrimination by religious organizations]." Scott Michelman, *Faith-Based Initiatives*, 39 HARV. J. ON LEGIS. 475, 498 (2002).

[9] *Compare* S. 1924 §§ 101-108 and §§ 201-212 *with* the Community Solutions Act of 2001, H.R. 7, 107th Cong. §§ 101-108 and §§ 301-307 (2001).

[10] *See* S. 1924 §§ 601-603 and §§ 501-505.

[11] *See* S. 1924 § 301. *See also* Ben Canada, *Faith-Based Organizations and Their Relationship with State and Local Governments: An Analysis of the Potential Impact of Current Legislation*, CRS Report RL31099 (Feb. 27, 2002) at CRS-8.

[12] *Compare* S. 1924 at § 301 *with* H.R. 7 at § 201(c)(1)(A), (e).

[13] *See* S. 1924 § 301. *See also* 148 Cong. Rec. S10993-01 at S10994 (daily ed. Nov. 14, 2002) (statement of Sen. Lieberman).

[14] *See* Witham, *supra* note 9.

[15] 148 Cong. Rec. S10993-01 at S10993 (daily ed. Nov. 14, 2002).

[16] *See* H.R. 7 § 201(c)(1)(A), (e).

[17] The following statutes bar discrimination when accepting federal funds: Title VI of the Civil Rights Act of 1964 (race, color, origin), Title IX of the Education Amendments of 1972 (gender), the Rehabilitation Act of 1973 (handicap), and the Age Discrimination Act of 1975. Individual programs, like Head Start, also prohibit discrimination on the basis of religion, although there is no such funding-based (e.g., not Title VII) prohibition generally. It should be noted that only Title IX affects employment (unless the purpose of a program is providing employment), although it contains an exemption for religious educational institutions. For a discussion of the foregoing, *see* Ackerman, *supra* note 6, at CRS-20-22.

[18] 42 U.S.C. § 2000bb (1993).

[19] The First Amendment provides, in pertinent part, that "Congress shall make no law respecting an establishment of religion, or prohibiting the free exercise thereof." U.S. CONST. amend. I.

[20] 494 U.S. 872, 890 (1990).

[21] 42 U.S.C. § 2000bb(a). These standards are taken from the pre-*Smith* jurisprudence of *Sherbert v. Verner*, 374 U.S. 398 (1963) and *Wisconsin v. Yoder*, 406 U.S. 205 (1972).

[22] 521 U.S. 507 (1997).

[23] The Fourteenth Amendment provides, in pertinent part, that "Congress shall have power to enforce, by appropriate legislation, the provisions of this article," which include rights to "privileges or immunities," "due process," and "equal protection." U.S. CONST. amend. XIV, §§ 5 and 1.

[24] *See, e.g., Guam v. Guerrero*, 290 F.3d 1210 (9th Cir. 2002); *Kikumura v. Hurley*, 242 F.3d 950 (10th Cir. 2001); *United States v. Ramon*, 86 F.Supp.2d 665 (W.D. Tex. 2000); *Sutton v. Providence St. Joseph Med. Ctr.*, 192 F.3d 826 (9th Cir. 1999); *In re Young*, 141 F.3d 854 (8th Cir. 1998).

[25] These exemptions can exist as express provisions in the state or local employment discrimination laws themselves (*see, e.g.*, Maryland (MD. CODE ANN. 49B, § 18 (2001)); Texas (TEX. LAB. CODE. ANN. § 21.109(a)-(b) (1996)) or can be state versions of RFRA (*see, e.g.*, South Carolina's Religious Freedom Act, S.C. CODE ANN. § 1-32-40 (2001)).

[26] *See Higgins v. Maher*, 210 Cal. App. 3d 1168 (1989); *Williams v. Episcopal Diocese of Mass.*, 766 N.E.2d 820 (Mass. 2002) applying "ministerial" exemption to state law.

[27] *See* H.R. 7, 107th Cong. §§ 201(d) and (e) (2001).

[28] *See, e.g.*, 42 U.S.C. § 2000e-1(a) *and* § 2000e-2(e) (federal exemptions only).

[29] As noted by Gregory P. Magarian in *How to Apply the RFRA to Federal Law Without Violating the Constitution*, 99 MICH. L. REV. 1903, 1911 (2001), RFRA "passed both Houses of Congress almost without opposition." (Citations omitted).

[30] *Corporation of Presiding Bishop v. Amos*, 483 U.S. 327, 335 (1987) (upholding Title VII exemptions for religious entities against Establishment Clause challenge).

[31] 42 U.S.C. § 2000e-2(a).

[32] 42 U.S.C. § 2000e-1(a). Note that the Americans with Disabilities Act of 1990 also provides an exception for religious institutions. *See* 42 U.S.C. § 12113(c).

[33] 42 U.S.C. § 2000e-2(e)(2).

[34] MICHAEL WOLF ET AL., RELIGION IN THE WORKPLACE: A COMPREHENSIVE GUIDE TO LEGAL RIGHTS AND RESPONSIBILITIES 21 (1998).

[35] *See id.* at 21-23.

[36] 42 U.S.C. § 2000e-2(e)(1).

[37] WOLF, *supra* note 35, at 24 *citing International Union, UAW v. Johnson Controls*, 499 U.S. 187 (1991).

[38] *See id.* at 23-26.

[39] *Pime v. Loyola University of Chicago*, 803 F.2d 351 (7th Cir. 1986).

[40] *Kern v. Dynalectron Corp.*, 577 F.Supp. 1196 (N.D. Tex. 1983), *aff'd*, 746 F.2d 810 (5th Cir. 1984).

[41] WOLF, *supra* note 35, at 12-13.

[42] *EEOC v. Roman Catholic Diocese*, 213 F.3d 795, 800 (4th Cir. 2000).

[43] *EEOC v. Catholic Univ. of Am.*, 83 F.3d 455, 461 (D.C. Cir. 1996) *citing Rayburn v. General Conf. of Seventh-Day Adventists*, 772 F.2d 1164, 1169 (4th Cir. 1985).

[44] *See* S. 1924, 107th Cong. § 301(e)(2) (2002) (defining "social service programs").

[45] *See* Laura Mutterperl, Note, *Employment at (God's) Will: The Constitutionality of Antidiscrimination Exemptions in Charitable Choice Legislation*, 37 HARV. C.R.-C.L. L. REV. 389, 420-21 (2002).

[46] *See* H.R. 7, 107th Cong. § 201 (2001).

[47] Mutterperl, *supra* note 46, at 398 *citing* 42 U.S.C. § 604a(b). *See also* Equal Protection of the Laws for Faith-Based Community Organizations, 67 Fed. Reg. 77,141 (Dec. 12, 2001).

[48] *See* 42 U.S.C. § 604(f).

[49] *See* Castegnera et al., Termination of Employment (West) at 20,101 (Aug. 1999) (Alabama), 22,101 (Apr. 2001) (Georgia), and 24,901 (Oct. 2000) (Mississippi).

[50] *See, e.g.*, state provisions in California (CAL. GOV'T. CODE § 12940 (1992)), Illinois (775 ILL. COMP. STAT. ANN. §§ 5/1-102 & 5/2-102 (2001)), Pennsylvania (43 PA. CONS. STAT. ANN. §§ 951-963 (1991)), and Texas (TEX. LAB. CODE ANN. § 21.101 (1996)).

[51] *See, e.g.*, New York City provisions (NEW YORK, NY ADMIN. CODE § 8-102 (1997)).

[52] *See* 42 U.S.C. § 2000e(b).

[53] *See, e.g.*, California's Fair Employment and Housing Act, CAL. GOV'T. CODE §§ 12926(d), 12940(a) (1992), which extends the protections of Title VII, among other laws, to employers with five or more employees (*see Robinson v. Fair Emp. & Hous. Comm'n*, 825 P.2d 767 (Cal. 1992)).

[54] *See, e.g.*, Connecticut's Fair Employment Practices Act, CONN. GEN. STAT. §§ 46a-51 to 46a-125 (1995), which, unlike federal law, extends to sexual orientation and marital status, or Ohio's Civil Rights Act, OHIO REV. CODE ANN. §§ 4112.01 to 4112.02 (2002), which has a limited exception for BFOQ, but, unlike federal law, offers no *per se* protection of religious employers.

[55] As Title VII itself provides, "nothing [herein] shall be deemed to exempt or relieve any person from any liability, duty, penalty, or punishment provided by any present or future law of any State or political subdivision of a State . . . ." 42 U.S.C. § 2000e-7.

[56] *See, e.g.*, Pennsylvania's "state contractor" non-discrimination requirements (including religion), 16 PA. CODE § 49.101 (1974). Under federal law, it is unlikely that Act participants would be "state actors" for "public contract" or constitutional purposes, at least as far as faith-based employment is concerned. *See* Michelman, *supra* note 9, at 497-500 (discussing weakness of "state actor" argument) *and* Title VI of the Civil Rights Act of 1964, 42 U.S.C. § 2000d (funded program protections only for race, color, origin).

[57] For a study of relevant state discrimination law, *see* PETER PANKEN, A STATE-BY-STATE SURVEY OF THE LAW ON RELIGION IN THE WORKPLACE (2001).

[58] *See, e.g.*, West Virginia's Human Rights Act, W. VA. CODE §§ 5-11-1 to 5-11-4 (1967) which provides a BFOQ, but no religious organization exemption; Arkansas' Civil Rights Act of 1993, ARK. CODE ANN. §§ 16-123-101 to 16-123-103 (1993) which provides a religious organization exemption, but no BFOQ; Virginia's Human Rights Act, VA. CODE ANN. § 2.2-3901 (2002), which, on its face, provides neither exemption.

[59] *See* state cases cited *supra* note 27.

[60] *See, e.g.*, South Carolina's Religious Freedom Act, S.C. CODE ANN. § 1-32-40 (1999), and similar provisions in Arizona, ARIZ. REV. STAT. ANN. § 41-1493.01 (1999), Florida, FLA. STAT. ANN. § 761.01; Alabama, ALA. CONST. AMEND. NO. 622 (1999) (although Alabama has no express state employment discrimination statute).

[61] *See generally*, H.R. 7, 107th Cong. (2001).

[62] *See* H.R. 7 § 201.

[63] *See id.* at § 201(e).

[64] *See generally*, S. 1924, 107th Cong. (2002).

[65] *See id.* at § 301(a), (b). Remarkably, the Senate Finance Committee's last reported version did not even contain most of these modest protections. *See* Ackerman, *supra* note 6, at CRS-12 (*citing* S. REPT. NO. 107-211 (July 16, 2002)).

[66] 148 Cong. Rec. S546-01 at S555 (daily ed. Feb. 8, 2002).

[67] 148 Cong. Rec. S10993-01 at S10994 (daily ed. Nov. 14, 2002) (statement of Sen. Lieberman).

[68] *See Bryce v. Episcopal Church in the Diocese of Colo.*, 289 F.3d 648 (10th Cir. 2002).

[69] *See id.* at 656 (*citing Roman Catholic Diocese*, 213 F.3d at 800; *Gellington v. Christian Methodist Episcopal Church*, 203 F.3d 1299, 1302-04 (11th Cir. 2000); *Combs v. Central Tex. Annual Conf. of the United Methodist Church*, 173 F.3d 343, 348-50 (5th Cir. 1999); *Catholic Univ. of Am.*, 83 F.3d at 461-63). Indeed, even *Smith* distin-

guished the religious "acts" there from "controversies over religious authority or dogma." *Id*., 494 U.S. at 877.

[70] *Roman Catholic Diocese*, 213 F.3d at 801.

[71] 148 Cong. Rec. S546-01 at S546 (daily ed. Feb. 8, 2002) (statement of Sen. Lieberman).

[72] *Id.* at S555.

[73] *See Flores*, 521 U.S. at 529-532.

[74] *See, e.g.,* S. 1924, 107th Cong. § 501 (2002).

[75] *See* 42 U.S.C. §2000e(b).

[76] 494 U.S. 872.

[77] 374 U.S. 403 (1963).

[78] 406 U.S. 205 (1972).

[79] 494 U.S. at 879.

[80] *Id.* at 881.

[81] *Id.* at 877 (citations omitted).

[82] *See Catholic Univ. of Am.*, 83 F.3d at 467 (regarding "hybrid" ministerial exemption).

[83] *See* Magarian, *supra* note 30, at 1911 (citations omitted).

[84] 42 U.S.C. § 2000bb(b)(1).

[85] 42 U.S.C. § 2000bb-1.

[86] *See Yoder*, 406 U.S. at 215-219; *see also* 42 U.S.C. § 2000bb-2(4).

[87] *In re Young*, 82 F.3d 1407, 1418 (8th Cir. 1996) (*citing Werner v. McCotter*, 49 F.3d 1476, 1480 (10th Cir. 1995)).

[88] *See In re Young*, 82 F.3d 1407 (tithing); *Weir v. Nix*, 890 F.Supp. 769 (S.D. Iowa 1995) (liturgy); *Gartrell v. Ashcroft*, 191 F.Supp.2d 23 (D.D.C. 2002) (grooming); *Catholic Univ. of Am.*, 83 F.3d 455 (employment of "ministers").

[89] *See Sherbert*, 374 U.S. at 404 (condition of unemployment benefit); *Sasnett v. Sullivan*, 908 F.Supp. 1429 (W.D. Wis. 1995) (prohibition of wearing crosses).

[90] *See Goehring v. Brophy*, 94 F.3d 1294 (9th Cir. 1996) (health and safety); *Fawaad v. Jones*, 81 F.3d 1084 (11th Cir. 1996) (prison security); *U.S. v. Hugs*, 109 F.3d 1375 (9th Cir. 1997) (endangered species protection); *Haff v. Cooke*, 923 F.Supp. 1104 (E.D. Wis. 1996) (Establishment Clause); *Good News Club v. Milford Central School*, 533 U.S. 98, 113 (2001) (saluting "suggestion" of Establishment Clause as a "compelling interest").

[91] 521 U.S. 507.

[92] *Id.* at 517.

[93] *Id.* at 532, 534.

[94] *See Guerrero*, 290 F.3d at 1219; *Kikumura*, 242 F.3d at 958; *Sutton*, 192 F.3d at 832; *In re Young*, 141 F.3d at 858-59; *Worldwide Church of God v. Phila. Church of God, Inc.*, 227 F.3d 1110, 1120 (9th Cir. 2000). *But see La Voz Radio de la Communidad v. FCC*, 223 F.3d 313, 319 (6th Cir. 2000) ("doubting" constitutionality); *Saleem v. Helman*, No. 96-2502, 1997 U.S. App. LEXIS 22572 at *4 (7th Cir. Aug. 21, 1997) (assuming without discussion).

[95] *Worldwide Church of God*, 227 F.3d at 1120.

[96] *See Flores*, 521 U.S. at 535-36.

[97] Magarian, *supra* note 30, at 1921-22.

[98] *In re Young*, 141 F.3d at 862-63.

[99] *Flores*, 521 U.S. at 534.

[100] *See* 147 Cong. Rec. H4102-01 at H4102-03 (daily ed. July 17, 2001) (statement of Rep. Edwards) and H4222-05 at H4229 (daily ed. July 19, 2001) (statement of Rep. Lee), alleging the "funding" of discrimination.

[101] 42 U.S.C. § 2000bb-4; *see also Sherbert*, 374 U.S. 398, which involved the denial of unemployment compensation benefits (as did *Smith*, 494 U.S. 872).

[102] *Catholic Univ. of Am.*, 83 F.3d at 467-68.

[103] *See* 147 Cong. Rec. H4102-01 at H4102-03 (daily ed. July 17, 2001) (statement of Rep. Edwards) and H4222-05 at H4228 (daily ed. July 19, 2001) (statement of Rep. Pelosi); *see also* 148 Cong. Rec. S546-01 at S546 (daily ed. Feb. 8, 2002) (statement of Sen. Lieberman).

[104] *See Amos*, 483 U.S. 327 (1987).

[105] *See* Ackerman, *supra* note 6, at CRS-24 (*citing*, *inter alia*, *Hall v. Baptist Mem. Health Care Corp.*, 215 F.3d 618 (6th Cir. 2000); *Siegal v. Truett-McConnell College*, 13 F.Supp.2d 1335 (N.D. Ga. 1994); *and Young v. Shawnee Mission Medical Center*, No. 88-2321-S, 1988 U.S. Dist. LEXIS 12248 (D. Kan. Oct. 21, 1988).

[106] 521 U.S. 203 (1997).

[107] 530 U.S. 793 (2000).

[108] 122 S.Ct. 2460 (2002).

[109] *See also* recent lower federal and state cases in the tax-exempt bond arena (e.g., *Steele v. Ind. Dev. Bd. of Metro. Nashville*, 301 F.3d 401 (6th Cir. 2002); *Virginia College Bldg. Auth'y. v. Lynn*, 538 S.E.2d 632 (Va. 2000)) approving the grant of such aid to religious institutions based on notions of "neutrality" and "private choice."

[110] *Id*. at 2467.

[111] 530 U.S. at 818-20 (noting the "special Establishment Clause dangers" of money).

[112] 397 U.S. 664, 675 (1970).

[113] *See* 530 U.S. at 844 (O'Connor, J., concurring), where O'Connor, to form a majority, posited that the religious nature of participants may matter, depending on the aid at issue.

[114] *See* Michelman, *supra* note 9, at 476, 497-502, concluding that discrimination might be one factor, but in itself "is a policy concern rather than a constitutional one." *See also* Ackerman at CRS-35, citing pre-*Mitchell* cases, including *Tilton v. Richardson*, 403 U.S. 672 (1971) for the proposition that "religious discrimination in employment, by itself, might not [be] enough to render a direct aid program unconstitutional."

[115] 515 U.S. 819 (1995).

[116] *See* H.R. 7, 107th Cong. § 201(c)(1)(A), (e) (2001).

[117] 494 U.S. at 887.

[118] *Luke* 8:52 (New American Bible).

TELECOMMUNICATIONS

ARE CLASS ACTIONS LAWYERS SYSTEMATICALLY TARGETING REGULATED INDUSTRIES?

*REMARKS BY WILLIAM BARR AND BARBARA HART**

MR. WILLIAM BARR: On June 20 of this year, the Second Circuit decided a case called *Law Offices of Curtis V. Trinko v. Bell Atlantic Corp.*, the so-called *Trinko* case, which, we believe, radically changed the antitrust law in two respects: it expanded the scope of duties that incumbent firms owed to rivals; and it changed the traditional standing limits that barred suits by indirect purchasers. It significantly broadened the kind of conduct that, it could be argued, violated the antitrust laws, and it significantly broadened the scope of the people who can bring these claims.

Since *Trinko* was decided, 25 class actions have been filed in the Second Circuit. Among those, I believe, twelve were filed against Verizon, six against SBC. Others have been filed outside the Second Circuit against Qwest, and BellSouth.

A fellow named Dan Berninger, who appears to be something of a class action apparatchik, has said that the goal is to turn the Bell companies into the next "asbestos" and "big tobacco". I think we all know what he means by that. I contend that these actions are really an end run around the regulatory process and will stultify the whole regulatory regime that has been developed by the FCC.

Generally, antitrust laws don't require companies to help their rivals. Even monopolies have no obligation to assist in any way companies that are attempting to compete against them. Basically, the antitrust laws impose negative duties and enjoin certain objectionable conduct. There are no affirmative duties to help or cooperate with their rivals.

Something that may appear, at first blush, to be an extremely narrow exception that has never been recognized by the Supreme Court and has rarely been invoked by lower courts is the so-called Essential Facilities Doctrine. It has been sparingly employed, and in certain narrow contexts it has been held that firms have to provide access to their facilities to other firms.

But in the context in which it's been previously applied, it has involved two markets—market one and market two. The notion has been that if facilities in market one are essential to competing in market two, then under certain circumstances, they will be made available to someone who is trying to compete in market two.

This has been done where the company that has the facilities in market one has voluntarily made them available to others. So the terms and conditions have been established in the marketplace. They are things to be set by courts in the abstract, but there's a course of dealing that essentially sets the benchmark. In that context, the courts have said that you can't refuse to deal with someone to keep them out of market two. You have to allow them access to your facilities on the terms and conditions that you've essentially set as reasonable by your own course of dealing.

Moreover, in these contexts the incumbent who owns the facilities has not been displaced from their facilities and they are not being required to reconfigure their business. This has only heretofore been a claim for access that a rival firm or a competitor can bring. Customers or consumers have never been allowed previously to make claims that business that they're buying from should have Essential Facilities rights in someone else's facilities.

That's the antitrust background.

In 1996, the Telecommunications Act was passed, and, as most of you know, the so-called Incumbant Local Exchange Carriers (ILECS), or primarily the Baby Bells, have been required under that act to provide access to their facilities to competing firms that are coming in to provide local phone service. This is a situation in which you're dealing with one market, and Congress is trying to get people to come in and compete in that market, and as part of that regime, Congress is saying to the incumbents that those entrants have to be allowed to use your facilities on certain terms.

The Act tells the FCC to set out elaborate rules about what has to be provided on what terms and conditions, and at what price. Accordingly, the FCC has set up what has to be one of the most complex and pervasive regulatory regulatory regimes in history.

It involves hearings before state regulatory commissions on the setting of pricing. Complex and numerous rule-makings on the various pros and cons of allowing access to certain parts of the facility are weighed. There are processes for adjudication of complaints that insufficient access is being provided. There are working groups where all sectors of the industry, the entrants and the incumbents alike, get together to discuss how to provide access.

This has required substantial reconfiguration of the local telephone network. It's involved billions of dollars of investment in new software and processes. These networks were not designed to provide a platform for multiple providers, and now they have to accommodate multiple providers. Extremely elaborate software, systems, and databases have had to be developed to do this.

The carrot for the ILECs to do this is that, once it's done and the FCC says that you've done this and therefore your market is sufficiently contestable or open to competition, then the local company can compete in the long-distance markets that heretofore the local companies had been prohibited from competing in.

In short, there's an elaborate process by which the issue of whether you have complied with the Act—and there-

fore, whether you can now compete to provide long-distance service—is adjudicated. These fights have been going on for several years. Basically, the long-distance companies are also CLECs (Competitive Local Exchange Carriers), and they're coming competing in local markets against the ILECs. They're among the companies that are trying to get access and use the facilities of the incumbents in local markets.

Long distance providers are coming in and using those facilities at very low prices, and at the same time they're trying to keep the local companies from moving up into the long-distance market. So there are usually scorched-earth regulatory battles as to whether the local companies are complying. The InterXchange Carriers—the long-distance companies—would say that you're not complying; you failed to do this, you failed to do that, you haven't done this well enough. They're trying to block the local company from the *quid pro qu*o of moving up and competing in the long-distance market.

So that's the framework.

Two years ago, the Seventh Circuit, in *Goldwasser v. Ameritech*, dealt with a case brought by a CLEC that was complaining about the quality of access that was being provided by the local company and saying that the local company wasn't going far enough in providing access to them. The District Court dismissed the case and the Seventh Circuit upheld the District Court.

Barbara Hart will give her view of the case, but the *Goldwasser* case, in my view, said that the claims brought by the CLEC were really duties not under the antitrust laws, but under the statute. They were affirmative duties to help that were created by Congress specifically in this area.

Furthermore, it's not proper to invoke the Essential Facilities Doctrine under the antitrust law in this particular context because it was incompatible with this regulatory regime that was established by Congress. More than a dozen district courts have followed *Goldwasser* and have dismissed these cases as they've been brought.

Trinko was then brought in New York. Trinko is a plaintiffs' class action law firm. It was a customer of AT&T, which, as I said, was a CLEC and therefore was trying to buy products on a wholesale basis from Verizon to resell to its customers.

There was an incident during Verizon's entry into long-distance in New York in which a piece of software in our wholesale order-processing apparatus, which was provided by a third party, failed. As a result, when CLEC's competitive companies were placing their wholesale orders, the orders were being fulfilled, but the part of the software that notified the CLEC that its order had been received and was being processed wasn't working in some cases.

AT&T made a huge fuss about this in the regulatory regime because it was asking the FCC to take away our permission to go into long distance, saying that our systems weren't up to snuff and that they were being impeded from competing. Largely to resolve this situation so that our ability to go into the long-distance business was not taken away, we agreed with the FCC that we would pay CLECs $10 million because of this problem, namely, the failure to notify them in a certain group of orders over a relatively brief period of time.

Again, there was no evidence of actual service disruption—these orders were in fact filled, and the customers did get the service.

The Trinko firm brought a class action based on this incident for the customers at AT&T on the grounds that AT&T's business was disrupted by this and therefore they as AT&T customers suffered injury. We petitioned the Second Circuit to dismiss, on the grounds that there is no antitrust duty to spend money and create this kind of elaborate software and processing system.

These were affirmative duties to assist created by the Act, not under the antitrust laws. Moreover, this would be the first time in history that an indirect purchaser, a customer of the firm, would be allowed to bring an Essential Facilities case. We lost on those grounds. As far as the case, we're seeking cert to the U.S. Supreme Court.

Among other difficulties with this case, it requires inquiry as to whether this is a proper area to expand the concept of Essential Facilities and develop this court-fashioned doctrine and to expand access to the courts to indirect purchasers, in this regulated context.

This idea of allowing hundreds of district court juries and treble damage actions to be deciding the terms of access to our facilities is fundamentally incompatible with the regulatory regime and Congress's plan under the Telecommunications Act.

The Telecommunications Act is clearly consistent with the notion that the FCC should be the one determining whether rivals need access. The Act did not give blanket access to rivals. It said that the FCC under a particular statutory standard should determine what parts of the network they would get access to.

The courts have said that this requires a balancing test. The purpose here is not just to be as profligate as you can in turning over parts of the networks to rivals, because that is counterproductive in terms of investment.

The intent of the Act was that you balance various public interests in determining how much access you give and for how long, and to stimulate investment not only by entrants, but also to keep the incentives for investment by the incumbents. That is a judgment call that the FCC is supposed to make by weighing a number of circumstances.

In a number of these cases, the basis of the claim is that the customer should have access to something that they weren't given access to; the FCC hadn't yet ordered access, but they should have had access under the antitrust laws. The FCC is meanwhile in the process of determining whether they should have acted, and whether, in fact, public policy should allow access to these facilities.

Trinko also seems to create a completely separate regime that is potentially inconsistent with FCC determinations of terms of access. The FCC sets highly articulated rules, such as that you have to provide something in 90 days after the order. Or it has to be at such and such a price. The

prices, by the way, are huge discounts that have never been required in the Essential Facilities context.

So as the FCC sets these terms and conditions, but part of these class actions suits have to do with the terms and conditions that we provided access on. They said that we didn't provide it fast enough. Well, we provided it within the time required by the FCC. Yes, they said, but our claim is not under the Act; it's under the antitrust laws—and under the antitrust laws, you may have had a duty to provide it faster.

The third area is the multiplicity of entities making the decision. The whole rationale for the Telecommunications Act and for the FCC setting out its multi-thousand-page orders dictating all the details to the states as to how this was to be implemented was that you could have one national entity that could make some of these decisions—because in many respects, these are national markets.

Under *Trinko*, we could have every district court judge and jury in America making these decisions as to what terms and conditions of access are reasonable under those circumstances.

It's also fundamentally inconsistent with the ultimate finding of competitive injury. In order to have an antitrust case, the issue is whether competition has been adversely affected. The FCC is ruling precisely on that issue when it determines whether the local company can get into long distance. In 80 percent of the markets that we've applied to so far to move into long distance, there have been huge battles as to whether the market is open. They get to put in their proof, and we put in our proof. They throw in everything but the kitchen sink, and they show every little flaw and glitch in our software system to claim that ours is an inadequate performance. The duly appointed commissions, the state commission, and the FCC make a ruling. We have won every one of those cases. The markets are open, and competition has not been adversely affected. Yet the core of the antitrust case is that we've impaired competition in that market.

The other area that is affected is the skewing of the regulatory process. Once you allow this second front—litigation in district courts under the broad principles of the antitrust law—to open up, then what parties ask for and are willing to agree to in the regulatory process, to the extent to which the parties actually come in and treat the regulatory process with respect and make their full case, are fundamentally altered.

We may be less willing to agree in the regulatory process to make certain concessions because now they've become the floor of district court treble damage antitrust liability. By the same token, companies may be changing what they seek in the process in order to position themselves for their second bite of the apple in court.

We've already seen evidence that some actors are essentially sandbagging the regulators, because rather than fighting out the battles in the regulatory process, they think that they don't have to worry about the regulatory process because they can hold this thing up and make their case in a district court.

This represents a radical expansion of antitrust principles, and is clearly not an arena for judges to be fashioning and expanding this Essential Facilities Doctrine because it's incompatible with the very detailed regulatory regime that was put in place by Congress.

MS. BARBARA HART: I have some prepared remarks, but unsurprisingly, I want to comment that I couldn't differ more strongly on the rendering of the *Trinko* decision. The *Trinko* decision was not a breakthrough in terms of antitrust standing, given that it followed Supreme Court and Third Circuit precedent to the letter in analyzing who the injured party and who an appropriate party is, and it was squarely within the *McCready* decision of the Third Circuit on *Illinois Brick*. Moreover, it was not a breakthrough decision on the issue of clear repugnancy that there was some type of conflict between the Telecommunications Act and application of the antitrust laws.

Finally, on the *Trinko* decision, the Second Circuit is very measured in its approach. It talks about damages as not being disruptive to the regulatory process or interfering with the regulators' oversight of the industry, whereas it would be more cautious in applying a remedy of injunctive relief.

So it's a very well-measured decision and within the confines of a great deal of precedent. I would actually wonder what ramifications it has for our *Goldwasser* decision, which we had the unfortunate experience of losing in the Seventh Circuit for reasons that Bill articulated.

As for what I had intended to say, I guess the not-at-all-subtle issue for today's caucus is to ponder whether class actions are engaging in undue or counterproductive efforts by targeting regulated industries. This discussion is akin to saying that the problem is not that there are maggots in your meat, but that Upton Sinclair dared to write about them.

In today's environment, where companies are regulated by the FCC or the SEC, or local regulatory authorities, and are imploding as Enron and WorldCom did, it's almost laughable to think that regulations are sufficient or vigorously enforced and that there's no role for the class action bar.

Uniformly, courts and regulators, including numerous previous SEC chairs and recently, the Seventh Circuit in the *ADM High Fructose* antitrust case, have recognized the significant role that the class action plaintiffs' bar plays in augmenting enforcement and regulatory efforts.

The government agencies are stretched beyond their abilities in light of budget constraints, and therefore also in light of staffing constraints. Let's face it: corporations engage a very high-powered, very sophisticated defense bar. They're not sitting there like pigeons for us to attack. They have their own defenses, which certainly are used in response to government inquiries.

Moreover, the idea that we target highly regulated industry is just not well taken. Undertaking cases where one is likely to encounter doctrines such as filed rate preemption, implied repeal, or primary jurisdiction is not typically what we do, for a variety of reasons, including the fact that those cases are expensive and we often lose them. So it doesn't make a lot of sense.

In the *Goldwasser* case, as has been discussed, we alleged violations of the Sherman Act and the Telecommunications Act based on allegations that Ameritech was routinely failing to comply with collocation requests and interconnection requests, akin to what has been alluded to regarding access for the carriers, which is mandated under the 1996 Act.

The idea is that these entities are already monopolies and that they are supposed to give access. We spent a lot of money on experts investigating the facts of this case; they even found that the fax machine was intended to run out of paper. The fax machine was supposed to take a lot of calls, but it would be busy for hours and hours so that the interconnection requests were going unanswered. It was intended not to comply with the requirements of the 1996 Act.

That case was very costly for my firm and for other firms that undertook the effort. We were dismissed by the district court based on filed rate and ultimately by the Seventh Circuit, based on the idea that the Telecommunications Act had imposed its own regulatory regime and that the antitrust laws wouldn't apply.

It's hard for class action lawyers to stay in business that way. We aren't targeting highly regulated industries.

Similarly, we've encountered issues such as implied repeal or plain repugnancy, which was alluded to in the *Trinko* case in the *In re options antitrust litigation*. Our firm and others spent significant time and resources litigating claims that the exchanges were not competing on the listing of options.

We all know what the benefits of competition are, and we all want to enjoy those benefits. We were alleging that the exchanges were not competing on the listing of options. All the exchanges, except the New York Stock Exchange, which had the most *de minimus* risk in this case, settled the case for $84 million. The New York Stock Exchange has thus far successfully held up that settlement by arguing the doctrine of implied repeal.

Judge Conway Casey agreed with the NYSE that plaintiff's claims were preempted despite the amicus views of the Justice Department and the SEC to the contrary. Judge Casey pointed to the fact that the SEC, in establishing the options market, had originally required only single listing of options.

In light of the prior regulation of the options market, Judge Casey found that the SEC, despite its argument in support of the application of the antitrust laws, could ultimately reassert its jurisdiction. He therefore held that he lacked jurisdiction to approve the settlement.

The idea was that somehow the SEC could whipsaw the exchanges by regulating, and then not regulating, and then one day deciding to reenter and reregulate. Therefore, the speculation regarding this whipsaw effect precluded—clearly, there was a plain repugnancy between the antitrust laws and the application of the antitrust laws—the possible reentry to regulate the options market.

The appeal in that case has been pending before the Second Circuit for over a year. So that $84 million settlement is just hanging in limbo. I would tend to say that the *Trinko* decision bodes well for the outcome that the Second Circuit will ultimately reach in light of the *Trinko* decision's holdings on the issue that there has to be a clear repugnancy between the specific regulatory regime and the antitrust laws for there to be a non-application of the antitrust laws.

My point being, we don't target regulated industries, except that, to some extent, all American industries are regulated. And to the extent that an industry is extensively regulated, it typically sends up flags as we analyze our cases, that we may have a hard row to hoe if we decide to undertake such a case for the reasons of the doctrines that I've already mentioned.

Yet when we do undertake such cases, we bring a real benefit. First, we compensate the victims. You'll find that almost no regulator compensates the people who have been injured.

For instance, in the CFTC case against Sumitomo, where the allegation was manipulation of the copper market, the CFTC got a breakthrough fine and a breakthrough recovery for the CFTC. Notwithstanding that, while a small portion of those monies was available to the victims of the copper-market manipulation, that small amount of money was not compensatory.

In fact, the class action bar—and I am involved in this case—will have ultimately recovered close to $100 million for the companies. In this instance, we're talking about companies—small businesses and large businesses and probably some telecommunications carriers—that purchased the manipulated copper, and they will get back money. Not from the regulators, but from the class action bar.

Second, we push the dialogue about issues. Look at tobacco. The tobacco industry argued vigorously that it was a highly regulated industry. That was its effort to take the sword and turn it into a shield. It said no, the class action bar and the attorneys general cannot sue us; we are a highly regulated industry.

The plaintiffs' bar and the attorneys general, through discovery of the fact that the tobacco industry was less than forthcoming with regard to additives in cigarettes that increased addictiveness and other knowledge that the tobacco companies had, helped bring about an enormous recovery that has changed the public's perspective about both the trustworthiness of big tobacco and the health effects of smoking.

Ultimately, we will have saved lives. So the dialogue, the pushing forward, where some might say we shouldn't be engaged in a policy discussion—to silence this additional voice would be very unfortunate.

This is also illuminated by the issue of prescription drugs. Class actions brought regarding monopolization by the brand name manufacturers will probably ultimately recover close to $1 billion cumulatively when you look at the monopolization of drugs such as Synthroid, Coumadin, Partisem, and some that are still pending regarding Buspar and Hytrin.

There the brand-name drug manufacturers have gamed the system, a highly regulated industry answering to the FDA. The Hatch-Waxman Act has supposedly put all

kinds of incentives into the industry for generic competition. Yet the industry is still gaming the system, and the class action bar has led to hundreds of millions of dollars in recoveries. In the end, it'll be close to a billion dollars in recovery for health-insurance companies as well as for consumers, and for union health and welfare funds that are paying the increased cost for prescription drugs.

In participating in that action, we've shaped the dialogue. Probably all of you are well aware that the Bush administration has come out in support of amendments to the Hatch-Waxman Act. We made that a hot-button and a palatable issue that the Republicans had to get behind. Drugs are clearly a regulated industry, yet I would argue that they weren't effectively regulated and that there was a role for the class action bar to play.

The other benefit that we bring to bear is our independence. Class action lawyers have the incentive to bring viable lawsuits, unlike the regulators, where we often see a revolving door from government to industry and sometimes back again.

I don't know why the plaintiffs' class action securities lawyers are never chosen to chair the SEC or even to act as a commissioner. Instead, you have the selection of someone whom the accountants are obviously comfortable with, a selection of cold comfort to investors and pensioners.

In this regard, the SEC is not unique. Regulated industries are big lobbying, big contributing, big players, and the regulators are not immune. Because the class action bar has the incentive to scrutinize, we will shine the harsh light on these industries, and we do have a role to play.

* William Barr is Executive Vice President & General Counsel, Verizon Communications. Barbara Hart is an attorney with Goodkind Labaton Rudoff & Sucharow LLP. Their remarks were part of The Federalist Society and Manhattan Institute's conference: "The New Class Action Targets: Are Class Actions Undermining Regulation in the Fields of Financial Services, High Technology, and Telecommunications?", held on October 30, 2002 at the Harvard Club in New York City.

Biting the Hand That Feeds: Can Telecommunications Competitors and Consumers Bring Antitrust Claims Based on Incumbents' Non-Antitrust Duties?

Decisions May Spur New Class Action Litigation

*By Robert Pambianco**

The telecom mess has gotten messier. Thanks to the ingenious efforts of enterprising class action lawyers, a split has emerged among three federal courts of appeals, further complicating the legal swamp created by the 1996 Telecommunications Act. The divergence occurs on the road where that statute intersects with the antitrust laws. And it involves this question: do allegations of inadequate performance of duties imposed by the 1996 Act—specifically duties that compel cooperation with competitors—state an antitrust claim?

The three cases at issue each involved suits brought against regional local telephone companies, specifically Ameritech, Bell Atlantic (now Verizon), and BellSouth. These companies, progeny of the old Bell System, are known as Incumbent Local Exchange Carriers, or ILECs. And all three suits involved allegations relating to the ILECs' obligations to open their respective markets to competition from entrants in the market for local telephony. These new entrants are commonly referred to as CLECs, or Competitive Local Exchange Carriers, a group that encompasses everything from the smallest upstart to established telecommunications giants like AT&T.

All three suits involved claims under both the antitrust statutes and the 1996 Act, as well as various state law claims. Each was an appeal from a district court decision granting a Rule 12(b)(6) motion to dismiss (for failure to state a claim) filed by the defendants in each case. In the first case, decided in 2000, the Seventh Circuit upheld the dismissal. In the two subsequent cases, both decided last year, the Second and Eleventh Circuits reversed the dismissals. Hence the Circuit split, and the petition for certiorari filed by Verizon last November in the Second Circuit case.

If the Supreme Court chooses to resolve this dispute, its decision would have profound implications for the future of competition in local telephony; it may also set the stage for a fresh onslaught of class action litigation.

The First Case: ***Goldwasser v. Ameritech***, 222 F.3d 390 (7th Cir. 2000).

The first case in this story was a class action suit against Ameritech, now part of SBC Communications. It was brought in Illinois on behalf of a class of Ameritech's customers who asserted that Ameritech failed to comply with the 1996 Act's sharing requirements, thus violating both the antitrust laws and the 1996 Act itself. Interconnection is the primary method by which the 1996 Act seeks to achieve competition in the market for local telephone service. Put simply, the Act requires that the incumbent carriers—the ILECs—allow new entrants to connect to their networks. In theory, this would jump start competition by enabling new market participants to offer local phone service without surmounting the hurdle of building their own facilities (telephone lines, switches, and so forth). The purpose of this article is not to explore the pros and cons of interconnection. But suffice it to say, interconnection has produced at best mixed results.

The *Goldwasser* opinion contains three main holdings. First, the court held that the plaintiffs had standing to sue under the antitrust laws. (They were customers of Ameritech and thus not indirect purchasers. They satisfied the antitrust injury requirement by alleging that they were charged monopoly prices. And they were not improperly asserting the rights of third parties, i.e. Ameritech's CLEC competitors.) Second, the court held that the plaintiffs failed to state a claim under Section 2 of the Sherman Act, which addresses monopolistic behavior. And third, the court held that plaintiffs' claims were barred by the filed-rate doctrine. It is the court's second holding (failure to state an antitrust claim) with which this article is primarily concerned.

Contrary to some press reports, *Goldwasser* did not hold that1996 Act provides ILECs with immunity, implied or otherwise, from antitrust suits. As the court observed, "Such a conclusion would be troublesome at best given the antitrust savings clause in the statute."[1] Rather, the court held that the1996 Act imposed a myriad of obligations on ILECs that go beyond what the antitrust laws require. And that those "more specific and far-reaching obligations" are not "coterminous with the duty of a monopolist to refrain from exclusionary practices."

More importantly, the court held that antitrust claims cannot be divorced from claims under the1996 Act when the antitrust allegations are inextricably linked to allegations pertaining to an ILEC's duties under the Act. In other words, when the supposed antitrust violations "are covering precisely the same field" as an allegation that the1996 Act has been violated, then the antitrust claims must yield to the Act's more specific requirements.[2] The Seventh Circuit reasoned that the two were incompatible and that allowing antitrust claims to proceed would undermine Congress' decision to deal with the competitive problems in the local market through regulatory mechanisms rather than through the "unadorned" antitrust statutes. Said the court, "the elaborate system of negotiated agreements and enforcement established by the 1996 Act could be brushed aside by any unsatisfied party with the simple act of filing an antitrust action."[3]

The Second Case: ***Law Offices of Curtis V. Trinko LLP v. Bell Atlantic Corp.***, 294 F.3d 307 (2d Cir. 2002).

Trial courts around the country relied on the *Goldwasser* ruling to dismiss similar suits. It seemed that the issue had been put to rest—until the Second Circuit proved that nothing relating to the1996 Act is easily settled.

Trinko originated in New York and was in many ways similar to *Goldwasser*. Like *Goldwasser*, it was a class action suit. But unlike *Goldwasser*, the plaintiff class did not consist of customers of the ILEC—in this case Bell Atlantic. Instead, the class consisted of CLEC customers, i.e., consumers who purchased their local telephone service from companies other than Bell Atlantic, which in turn partly relied on Bell Atlantic in order to provide telecommunications services.

Because the *Trinko* plaintiffs were not Bell Atlantic's customers, the indirect purchaser doctrine was clearly in play. Normally, under the Supreme Court's ruling in *Illinois Brick Co. v. Illinois*, 431 U.S. 720 (1977), indirect purchasers lack antitrust standing. But the Second Circuit held that the plaintiffs had antitrust standing because AT&T was not only a purchaser of services from Bell Atlantic, but also Bell Atlantic's competitor. "Action meant to injure a competitor," said the court, "can directly harm the consumer who chooses to do business with the competitor."[4] Thus the alleged injury in *Trinko* was not that the plaintiffs were forced to pay monopolistic overcharges (as alleged in *Goldwasser*), but rather that they received poor service from AT&T as a result of the ILECs' alleged interference with AT&T's ability to compete.

The court then addressed the Sherman Act claims themselves. After taking considerable time to explain that the1996 Act did not provide implicit immunity from antitrust claims, the Second Circuit held that the plaintiffs had met their burden of stating an antitrust claim. In doing so, the court sought to distinguish the underlying factual allegations from those in *Goldwasser*. In essence, the court said that *Goldwasser* was different because there the antitrust allegations amounted to no more than allegations that the defendant had violated its duties under the1996 Act. In other words, in *Goldwasser* the plaintiffs alleged that Ameritech's failure to comply with the1996 Act constituted illegal conduct under the Sherman Act. But since the *Trinko* plaintiffs had styled their antitrust claim without mentioning Section 251,[5] the court was able to find that their complaint may have successfully described conduct that would support an antitrust claim under such theories as the essential facilities doctrine or monopoly leveraging. According to the court, "there is no requirement that an allegation that otherwise states an antitrust claim must not rely on allegations that might also state a claim under another statute."

Such semantics miss *Goldwasser*'s essential point: there is no antitrust claim if the allegations supporting that claim are inextricably linked to an ILEC's duties under the1996 Act. This seems only logical since it is hard to imagine the existence an antitrust suit existing outside the parameters of the1996 Act. The *Trinko* opinion seems to acknowledge this when it discusses the need to provide a cause of action to consumers.

The court explained that the1996 Act provides a legal remedy to carriers injured by an ILEC's failure to comply with its statutory obligations, while offering no legal recourse to consumers. So by allowing the antitrust suits, consumers will be able to sue somebody for violations of the1996 Act. The implication is unmistakable: Whatever the social benefits of creating a new cause of action for consumers, the allegedly illegal conduct, regardless of its name, is inseparable from the1996 Act.

The Third Case: *Covad v. BellSouth*, 299 F.3d 1272 (11th Cir. 2002).

The Second Circuit's concern with ensuring that consumers not be denied access to the courthouse was not a factor in the third case in this trilogy, because this case was not a consumer class action. *Covad* was filed in District Court in Georgia. The plaintiff was an Internet service provider, specifically a provider of DSL service (high speed Internet service that is delivered over local telephone lines and comparable to that provided by a cable modem or other broadband service).[6] Consequently, standing was not an issue; the plaintiff was neither an indirect purchaser nor somehow standing in a third party's shoes.

In *Covad*, the Eleventh Circuit's opinion picks up on the immunity issue, offering an even more elaborate analysis than that provided in *Trinko*—with an extensive discourse on the legislative history, replete with quotes from Congress, the FCC, and even former President Clinton. The court's decision: there is no express or implied immunity. Interestingly, in each of the three opinions discussed in this article, the immunity issue was explored in progressively greater detail, even though none of the opinions argued that the1996 Act provided immunity.

Finally, and again with considerably more analysis, *Covad* held that, at least for purposes of surviving a motion to dismiss, the plaintiff had successfully stated an antitrust claim. The reasoning is similar to that employed in *Trinko*. According to the court, Covad's complaint adequately alleged three antitrust claims: first, that BellSouth used its monopoly power to deny access to an essential facility ("namely its network of telephone lines"[7]); second, that BellSouth's conduct amounted to an impermissible refusal to deal; and third, that BellSouth had engaged in an illegal price squeeze. The court recognized that all three theories flowed from "Covad's allegation that BellSouth engages in what is known as 'monopoly leveraging.'"[8]—i.e., that BellSouth was able to use its dominant position to deny competitors access to the market.

The court stressed that it was not venturing an opinion on the ultimate viability on the merits of such claims, or even whether any of them would survive a Rule 56 motion for summary judgment. Instead, the Eleventh Circuit emphasized that it merely held that Covad's complaint had met the "exceedingly low threshold" that applies to Rule 12(b)(6) motions to dismiss for failure to state a claim.

Problems with1996 Act

At the outset, it should be noted that much of the confusion here is rooted in the unsatisfactory nature of1996 Act. As the Supreme Court has observed, "It would be gross understatement to say that the Telecommunications Act of

1996 is not a model of clarity. It is in many important respects a model of ambiguity or indeed even self-contradiction."[9]

The apparent conflict between the antitrust savings clause and the Act's mechanisms for encouraging competition in the local market (chiefly 47 U.S.C. §§ 251, 252) is but one of many inconsistencies contained in a statute that very much reflects the process that lead to its passageThe much-heralded1996 Act was the product of years of lobbying by the various parties in the telecommunications industry. These factions had different goals. And Congress' response was to give a little bit to everybody, so that no one went a home a loser. The result has been anything but pretty. As shown by the ensuing rulemakings, lawsuits, appeals, remands, subsequent appeals, and further remands, the1996 Act has largely failed to live up to its promise of creating a telecom utopia of convergence and competition.

That said, however, it appears that the Seventh Circuit in *Goldwasser* did a better job—both from the standpoint of logic and in terms of fidelity to the1996 Act—of reconciling the apparent disparity created by the savings clause.

The *Trinko* and *Covad* opinions argue convincingly and exhaustively that the1996 Act provides no immunity from suits under the Sherman or Clayton Acts. But this is largely a one-side argument, since the *Goldwasser* court never held that the1996 Act provided such immunity. To the contrary, *Goldwasser* observed that immunity would most likely conflict with the antitrust savings clause.

Goldwasser's holding was that no antitrust claim exists when the antitrust allegations are inseparable from claims arising from an ILEC's obligations imposed by the1996 Act. Both *Trinko* and *Covad* strive to explain the theoretical possibility of a freestanding essential facilities antitrust claim.[10] But such analysis seems to miss the whole point of the1996 Act, the premise of which is that the local loop (the copper wires connecting your telephone to the local central office) is a bottleneck that creates an obstacle to competition. The theory is that it would be too expensive for a competitor to build the infrastructure to compete with the incumbent carrier. So the Act mandates interconnection as an alternative to facilities-based competition.[11]

Alleging that an ILEC uses its monopoly power to control a strategic bottleneck (essential facilities) is nothing more than saying that the ILEC is violating the1996 Act's local competition provisions. Moreover, as a matter of law, it would seem problematic to suggest that the ILEC is able to improperly leverage monopoly control over essential facilities. Whether or not they are essential, the1996 Act requires ILECs to provide access to those facilities. It seems only logical that an antitrust claim cannot be based on an incumbent's refusal to deal, when the incumbent is statutorily required to deal.

Indeed, in enacting the1996 Act, Congress may well have been aware of the antitrust laws' limitations when it comes to imposing a duty to deal with competitors.
One may choose those with whom he does business, and the general rule in antitrust is that a firm can refuse to deal with another firm. Any compulsion to deal is narrowly construed. The essential facilities "doctrine," upon which the *Trinko* and *Covad* opinions rely so heavily, is at best a thin reed; the 11th Circuit's assertion notwithstanding, it is anything but "well-established."[12] To the contrary, it is widely condemned as inimical to the competitive goals of antitrust. The authors of the leading antitrust treatise argue that enforcement of the doctrine does nothing to benefit consumers and can have the perverse affect of perpetuating a monopoly:

> Forcing a firm to share its monopoly is inconsistent with antitrust basic goals for two reasons. *First*, consumers are no better off when a monopoly is shared; ordinarily, price and output are the same as they were when one monopolist used the input alone. *Second*, the right to share a monopoly discourages firms from developing their own alternative inputs.[13]

The treatise authors explain that antitrust strives to "…permit firms to enter and operate in markets *to the extent they are capable of supplying their own inputs*…." And they express the view that the essential facility doctrine is "both harmful and unnecessary and should be abandoned."[14]

Criticism of the doctrine is rooted in economics and is not unlike the arguments against free riders: competition does not thrive not when a competitor can rely on assistance from a dominant firm by sharing a network. As Justice Breyer famously observed, "It is in the *un*shared, not in the shared, portion of the enterprise that meaningful competition would likely emerge."[15]

Antitrust Litigation is Incompatible with the Regulatory Approach Favored by Congress

Where does all this leave the savings clause? According to the Seventh Circuit's *Goldwasser* decision, it applies to those telecommunications markets not subject to the "detailed regulatory regime" established by the1996 Act:

> There are many markets within the telecommunications industry that are already open to competition … as to those, the antitrust savings clause makes it clear that antitrust suits may be brought today. At some appropriate point down the road, the FCC will undoubtedly find that local markets have also become sufficiently competitive that the transitional regulatory regime can be dismantled and the background antitrust laws can move to the fore.[16]

Thus it is incorrect to read *Goldwasser* as saying the Seventh Circuit would affirm all dismissals of antitrust claims; in those cases where competitors are alleging anticompetitive behavior unrelated to imposed duties, antitrust claims could proceed. Certainly, one could envision hypothetical situations where antitrust claims were raised with respect to an illegal group boycott or horizontal restraint of trade or price fixing arrangement. Likewise, it would take little imagination to speculate on merger issues arising under the Clayton Act. Further, were a CLEC to attempt to compete on an equal basis with an ILEC and not take advantage of the 251 and 252 mechanisms, this might be a scenario where the savings

clause could come into operation and allow a theoretical antitrust claim.

On a superficial level, the *Trinko* and *Covad* holdings may seem more compatible with the savings clause, particularly if that clause is considered in a vacuum. But *Goldwasser* seems the only correct view when the savings clause is read in the context of the whole statute, which reflects Congress' decision to rely on regulation—rather than antitrust litigation—as its preferred remedy for the competition issues in the local market.

Congress could have opted to simply deregulate telecommunications—to fling the doors wide open to competition, leaving the antitrust statutes and the courts to deal with anticompetitive behavior. There is much to commend such an approach. But it is not the one Congress chose. Indeed one of the key purposes of the1996 Act was to end judicial oversight of the telecommunications industry. The one thing in the legislation about which there has never been any dispute is that it removed federal district court Judge Harold Greene's from his role as enforcer of the antitrust consent decree that had largely governed the industry ever since the AT&T breakup.

The1996 Act spelled out a policy for encouraging competition in the local telephony market; the heart of that policy is interconnection, i.e., mandating that ILECs open up their networks to competitors, allow competitors to collocate equipment in their facilities, and provide access to unbundled network elements according to some Byzantine formula for determining prices. Further, Congress gave responsibility to implementing and overseeing this process to the FCC. Put another way, Congress recognized that there was a competition (antitrust) issue in the local market. And Congress provided a remedy—which exceeded what would be required by the antitrust laws (since even monopolists are not typically required to allow their competitors use of their property).

What this means is that a CLEC cannot have its cake and eat it too. The1996 Act gives CLECs a leg up in offering services that compete with the incumbent, because Congress wanted to encourage CLECs to enter the market. And it did so by enabling them to offer service with a minimum of investment—forcing the incumbent carrier to cooperate with them, and laying down rules for how that cooperation will unfold, and (in the ILECs' view) forcing ILECs to provide access at below market rates.

The Act, however, does not require CLECs to follow this approach. There is nothing than prevents facilities-based competition (although there is a strong argument that it unintentionally discourages such competition). But it makes no sense to say that a carrier can avail itself of all the advantage of the Telecom Act, piggyback on the incumbent carrier, but still avail itself of the traditional antitrust remedies.

Not only does the1996 Act require ILECs to cooperate with their competitors, it also places restrictions on the ILECs' ability to offer long distance service. Under Section 271, ILECs are prevented from providing in-region interlata service until such time as the FCC decides (via a 14-point checklist contained in the Act) that the ILEC in question has sufficiently cooperated in opening its local market to competition. It is hard to conceive how this process would not be seriously undermined by antitrust suits such as those in *Goldwasser*, *Trinko*, and *Covad*. The result would be a situation where the FCC decided (as it has many times) that an ILEC had met its obligations under Section 271 (in other words, finding that it was not engaging in improper monopolistic behavior), but a jury in a civil case could decide that the same ILEC had violated the Sherman Act. And it is precisely that point that the *Trinko* and *Covad* decisions fail to grasp; antitrust litigation in an environment where the government has prescribed exactly how competition will occur is absurd.

Conclusion: Legislation Plus Regulation Equals Litigation

The notion of antitrust litigation in the context of the telecommunications industry always carries with it a certain amount of amusement. Indeed, the history of telecommunications policy in the United States stands as testimony to the theory that monopolies are largely the product, intentionally or otherwise, of government regulation. The great irony of this litigation is that before the 1996 Act, it would be extremely difficult (although not impossible[17]) for a party to sue an ILEC on antitrust grounds because they were state-sanctioned, state-protected monopolies. But after the1996 Act, when the ILECs are no longer monopolies, they can be sued—at least according to two federal appeals courts. In other words, so long as you are an official monopolist, you are safe from antitrust lawsuits. But if Congress passes a statute that make you cooperate with your less-dominant competitors, *then* you can be sued for being a monopolist.

Of course, none of this makes any sense. But that could be said of many things associated with the1996 Act. And so perhaps this is one time where it is hard to blame the courts for being confused. If you are not confused, you should be.

Up until now, however, most of this confusion has been confined to battles about regulation. Now, a new element has been introduced. No doubt attracted by the prospect of the treble damages available in antitrust, as well as the nearly limitless supply of potential class members (do you have a phone?), the trial lawyers have decided to get in on the act.

The1996 Act produced enough legal headaches apart from this problem. Indeed, as mind boggling as the Telecom Act and its regulatory and judicial progeny have been, they appear almost manageable when compared to the intractable legal, social, and public policy problems associated with class action litigation. One mess at a time.

* Robert Pambianco is an attorney in Washington D.C.

Footnotes

[1] The antitrust savings clause provides that "[N]othing in this Act … shall be construed to modify, impair or supercede the applicability of any of the antitrust laws." 47 U.S.C. § 154.

[2] 222 F.3d at 401.

[3] *Id*.
[4] 294 F.3d at 325 (relying on the Supreme Court's decision in *Blue Shield of Virginia v. McCready*, 457 U.S. 465 (1982)).
[5] 294 F.3d at 326.
[6] Many Internet service providers are also CLECs because they use the ILECs' telephone lines (the twin copper wires) to operate their service. Indeed, in the years following passage of the1996 Act, much CLEC activity was taken up by Internet providers. Partly because of economics and partly because of regulatory changes relating to access charges, much of that business has evaporated.
[7] 2002 WL 1777009, at *7
[8] *Id.* at *8.
[9] *AT&T Corp. v. Iowa Utilities Bd.*, 525 U.S. 366 (1999).
[10] The *Covad* decision discusses three potential antitrust claims. But they all proceed from the central premise that the allegedly illegal behavior springs from the ILEC's monopoly control of its telephone lines and network.
[11] This process arguably has had the opposite effect than what was envisioned. By enabling new entrants to use the incumbent's existing facilities, the1996 Act has produced a poor substitute for genuine competition, while discouraging carriers from investing in building new facilities.
[12] 2002 WL 1777009, at *9.
[13] III A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law* § 771b.
[14] *Id*. at § 771c.
[15] *Iowa Utilities Bd.*, 525 U.S. at **429** (Breyer, J., concurring in part and dissenting in part).
[16] 222 F.3d 401-02.
[17] MCI successfully sued AT&T on some antitrust theories in a famous 1983 case. *See MCI Communications Corp. v. AT&T Co.*, 708 F.2d 1081 (7th Cir. 1983).

Book Reviews

Judge Dave and the Rainbow People by Judge David Sentelle

By C. Boyden Gray

In writing a review of Judge David Sentelle's book, *Judge Dave and the Rainbow People*, I have significant conflicts of interest: I was a law school classmate of David's at UNC Law School, I am a native of North Carolina who spent time in the mountains not far from the locus of this book, and I practice administrative law which is greatly affected by the court where David sits. I might therefore be expected to give a good review, whatever I really thought.

Well, let me tell you, this book is a gem, and a must read for anyone interested in the law, or who wants to be greatly amused for 250 pages. It is, of course, especially amusing if you know David Sentelle.

But first, a little context.

The story is about a bunch of middle-aged hippies who want to have their annual camp-out meeting at a national park in the mountains for western North Carolina. State and federal officials believe the hippies are in violation of the applicable law controlling the size of campsites. The hippies, on the other hand, believe the law violates their rights of free speech.

These legal questions quickly land on the desk of Judge David Sentelle, a federal district judge recently nominated by President Reagan to the DC Circuit. What law applies, federal or state? does a federal judge have jurisdiction? is it the North Carolina law, which strictly construed may not permit the gathering, subject to being ruled unconstitutional by a federal judge, especially considering that he is a conservative nominee awaiting confirmation by the Democratic Senate to the Court of Appeals for the DC Circuit? And why cannot Judge Dave, as the hippies call him, duck this whole thing and ship it down to the local courts?

In this delightful book, Judge Dave runs through the legal issues, and then sidesteps them altogether. For me, this is the most instructive part of the book, because of the obvious tension between the need to observe the rule of law and need to maintain peace and tranquility, otherwise known as common sense.

The book is a masterpiece of storytelling about how Judge Dave found a way to resolve this tension without compromising his principles or the rule of law. But you won't get the point if you don't have a sense of humor. At the same time, it is impossible to read the book and not laugh.

When he informed a friend that he had spent a day at a "mass hippie gathering," there was a long pause and the friend replied, "I know you want to seek favor with the liberals, Sentelle, but this is ridiculous." Of course, David would have been confirmed anyway. But the book speaks for itself as to the nature of the experience and how much despite himself, David enjoyed it. And any reader will enjoy it too, for the book is edifying and highly amusing. The only problem with it is that it eventually comes to an end.

Bush v. Gore: The Question of Legitimacy edited by Bruce Ackerman

By Nelson Lund

The 2000 election generated the most famous Supreme Court decision of recent times. *Bush v. Gore: The Question of Legitimacy*, a collection of essays edited by Bruce Ackerman, will lead almost every reader to conclude that *Bush v. Gore* was wrongly decided, or worse. In fact, much worse. Eleven of the thirteen essays were written by liberal academics who denounce the decision in terms that range from harsh to hysterical. And neither of the two essays by conservatives unequivocally defends the decision's legality. Surprising as it may be to outsiders, the book is a pretty fair reflection of the academic literature, which is large and growing. Indeed, I know of only one law review article defending the legal merits of the Court's opinion. I wrote that article, and its most salient feature may be how singular it has proved to be.[1]

As everyone knows, the Supreme Court's decision in *Bush v. Gore* came at the end of a complex and multifaceted process of legal and political maneuvering, much of which involved the intricacies of Florida election law. For present purposes, however, one can get by with a very brief summary.

After the initial count of the ballots, which had Bush ahead by a small margin, and an automatic recount authorized by state law, which also gave Bush a small lead, Gore asked for additional recounts by local election officials in four heavily Democratic counties. Overruling Florida's Secretary of State, the Florida Supreme Court granted an extension of time for these recounts to be conducted, but two of the counties failed to meet the new, court-ordered deadline. The Secretary of State then declared Bush the winner of Florida's electoral votes, and Gore filed a lawsuit contesting the outcome. He made a number of demands, all of which were rejected by the trial court. Three of those demands, however, were ultimately granted by a 4-3 vote of the Florida Supreme Court, which ordered the trial court to take the following steps:

- Add at least 176 votes to Gore's total, based on the Palm Beach County recount, whose results were not reported to the Secretary of State before the court-ordered deadline.
- Add 168 votes for Gore to the vote totals, based on an *uncompleted* recount conducted in Miami-Dade County that had begun with the more heavily Democratic precincts in that jurisdiction.
- Conduct a manual recount of 9,000 Miami-Dade "undervote" ballots, which Gore claimed might shift the statewide totals in his favor.[2]

The Florida Supreme Court also provided for one more form of relief, which Gore had *not* requested:

- Conduct a statewide recount of the "undervote" ballots in each county.

The U.S. Supreme Court reversed the Florida court, holding that this four-part order (whatever its merits may have been as an interpretation of state law) violated the Equal Protection Clause. Without concluding that any one element was constitutionally fatal, the Court held that the combination of the following facts prevented the order from satisfying "the minimum requirement for non-arbitrary treatment of voters necessary to secure the fundamental right" to vote.

- Varying standards for determining a voter's intent had been employed by the counties in which manual recounts had been held, and at least one county changed its standard repeatedly during the recount. Nor had any provision been made for a uniform standard in the statewide recount of undervotes.
- Unlike the recounts in the Gore-selected counties, which had included all ballots, the statewide recount was limited to "undervotes," and did not even include the analytically indistinguishable "overvote" ballots.
- Partial results from the uncompleted recount in Miami-Dade had been used to credit one candidate with additional votes, and the Florida court evidently contemplated the future use of partial recounts.
- The statewide recount was being conducted by untrained personnel, unguided by objective standards for identifying legal votes, and observers were not permitted to make contemporaneous objections.

The Court relied for its decision primarily upon *Reynolds v. Sims* (1964) and related cases. The essence of the Court's argument was that these vote-dilution cases prohibit a state from arbitrarily treating ballots differently depending on where they are cast. Acknowledging that it is impossible to treat every ballot or every voter absolutely identically in all respects, the Court concluded that the recount ordered by the Florida court was permeated with avoidable and unjustified nonuniformity, in violation of the prohibition on vote-dilution articulated in *Reynolds*.

An Affront to the Rule of Law?

The two most powerful essays in this collection are by Charles Fried and Bruce Ackerman.[3] Let me begin with Professor Fried, whose contribution appears at the beginning of the volume. Professor Fried contends that *Bush v. Gore* was a reasonable decision, about which reasonable people may disagree. When one recalls that the Court rested its decision on the Equal Protection Clause, it should be apparent why this is a very easy position to defend. Because all laws treat some people differently than others, and because the Court decided long ago that the equal protection of the laws means the protection of equal laws, the jurisprudence of equal protection has become a never-ending exercise in drawing judicially-created lines between permissible and impermissible forms of inequality. Almost any equal protection decision can therefore be defended, or criticized, with some sort of reasoned argument.

Rather than rehearse the arguments here, suffice it to say that lots of people have defended the equal protection holding in *Bush v. Gore*. Of the sixteen judges who reviewed the equal protection claim in this case, ten of them agreed that the challenged recount order in Florida violated equal protection (three members of the Florida Supreme Court and seven members of the U.S. Supreme Court). Even the liberal academics who appear in the Ackerman volume are split on this issue, with several of them agreeing that the Court's equal protection holding is at least defensible.

Consistent with his claim that this was a decision about which reasonable people can disagree, Professor Fried devotes himself to skewering a number of the many irresponsible and unreasonable attacks that have been made against the Court. He does this quite effectively, but most readers will probably forget just how effectively by the time they have waded through the twelve succeeding essays. For once, it was apparently not an advantage to get the honor of the lead position in a collection of essays.

This may not matter much, however, because Professor Fried does *not* skewer the Court's critics on the crucial point. The most serious "rule of law" charge that the liberals make in this volume is that a narrow 5-4 majority wrongly forbade the Florida Supreme Court to conduct a new recount using procedures consistent with the equal protection holding announced in *Bush v. Gore*. On this question about the remedy in the case, the liberals are united in denouncing the Court's decision as completely indefensible. Professor Fried himself calls this "the most vulnerable part of the Court's opinion," and he seems to suggest that his mind is open to the possibility that what the Court did was unlawful.

Unlike Professor Fried, I believe that the charge against the Court on this issue is sufficiently serious to require a judgment about its validity. If the Court had no legal basis for its remedial order, then the Court's critics have a real case for advocating drastic *political* action in response. That case is made most effectively by Professor Ackerman, whose strongest arguments may be summarized as follows. The 5-4 split in this case is the same 5-4 split reflected in a well-known series of federalism cases that have bitterly divided the Court. These cases may be the leading edge of an important shift in constitutional law, but that shift will almost certainly not occur if even one member of the "federalist five" is replaced by a new Justice who joins the four dissenters. Those five therefore had a strong motive for ensuring that a conservative Republican President will make the next appointments to the Court, and their blatantly illegal decision in favor of Bush, we are told, strongly served their interest in protecting and extending their ideological legacy.

Accordingly, says Professor Ackerman, just as Congress prevented Andrew Johnson from appointing any Justices—on the ground that he became President by an act of John Wilkes Booth, rather than of the American electorate—so too should the Senate refuse to confirm any new Justices until after the people have selected a president in a less questionable election in 2004.

In one sense, this is a powerful argument. I suspect that many members of the Federalist Society would agree that if the Supreme Court had issued a blatantly illegal decision that gave the presidency to Hubert Humphrey, it would have been appropriate for the Senate to wait for another election before confirming replacements for Earl Warren, John Harlan, Hugo Black, and Abe Fortas.

The strength of this argument depends largely on the premise that *Bush v. Gore* was blatantly illegal, and the Ackerman volume as a whole makes the premise appear all but self-evident. The liberals in this volume agree that *Bush v. Gore* was a lawless decision, and neither of the conservative contributors disputes the claim that the Supreme Court usurped the Florida court's right to attempt a recount using constitutionally permissible procedures. If the Supreme Court committed such a usurpation, it would be difficult indeed to defend it against the charge of lawlessness.

Fortunately, this charge is false, for it attributes to the Court an order that nowhere appears in its opinion. Unfortunately, however, the charge has been repeated so many times, and with such self-assurance, that it threatens to become the accepted interpretation of the case. It is therefore of some importance to refute it.

The roots of the attack on the Court's remedy lie in the dissenting opinions of Justices Souter and Breyer, who wanted to remand the case to the state court for a new recount. The Souter/Breyer approach, however, was *legally untenable*, and for exactly the reasons given by the majority. On December 11, just one day before the decision in *Bush v. Gore*, the Florida Supreme Court had issued an opinion in a different case arising from the Florida election controversy. In that opinion, the Florida court had *repeatedly* indicated that state law required that manual recounts be completed in time for the state to take advantage of a federal "safe harbor" statute that purported to give conclusive effect to the state's choice of electors if the election controversy was resolved by December 12.[4]

Thus, the Florida Supreme Court had already concluded, *as a matter of state law*, that recounts had to be concluded by December 12. Whatever the merits of this interpretation of the Florida election statutes, it was the interpretation adopted by the Florida Supreme Court only one day before the decision in *Bush v. Gore*. Thus, if the U.S. Supreme Court had remanded the case on December 12 with instructions or encouragement to conduct a recount under constitutionally adequate procedures, as Souter and Breyer advocated, it would have been ordering or inviting the Florida court to violate Florida law *as construed by the Florida Supreme Court*. The U.S. Supreme Court simply had no grounds for doing that because the ensuing violation of state law would not have been dictated by any requirement of federal law.

It is true that the Florida court's discussion of the binding nature of the December 12 deadline came in a case involving a different part of the Florida election code than the part that gave rise to *Bush v. Gore*. But the Florida court's

December 11 opinion made it plain that this should make no difference at all:

> As always, it is necessary to read all provisions of the [Florida] elections code in pari materia. In this case, that comprehensive reading *required* that there be time for an elections contest pursuant to section 102.168, which all parties had agreed was a necessary component of the statutory scheme and to accommodate *the outside deadline* set forth in [the federal "safe harbor" statute] of December 12, 2000.[5]

Furthermore, it would be extremely strange to suppose that the Florida court issued its December 11 opinion without considering the obvious implications for the case that was at that very moment pending before the U.S. Supreme Court. The Florida court's decision below in *Bush v. Gore* itself, moreover, referenced the federal "safe harbor" statute, without mentioning any alternative possible deadlines.[6] The U.S. Supreme Court simply had no basis at all for inferring that some deadline other than December 12 would be applicable under state law to the litigation in *Bush v. Gore*.

Still, one might say, the Supreme Court should at least have remanded the case to the Florida court so that it could reexamine the state law question itself. Perhaps that court would have concluded that state law ultimately subordinated the December 12 deadline to the goal of obtaining a constitutionally acceptable hand recount.

Fair enough. *But that is exactly what the Supreme Court did*. Contrary to repeated assertions in the Ackerman volume and elsewhere, the Supreme Court did *not* forbid the Florida court from attempting to conduct a statewide recount under constitutionally permissible standards. That would have been the effect of a judgment that reversed the Florida court and remanded with instructions to dismiss the case. But the Court did *not* order the case dismissed. Instead, it reversed and remanded with instructions "for further proceedings not inconsistent with this opinion." And the Florida court could indeed have ordered a new recount without acting inconsistently with the Supreme Court's opinion.

The only statement in the Supreme Court's opinion that might even conceivably be considered "inconsistent" with a new recount is the following:

> Because the Florida Supreme Court has said that the Florida Legislature intended to obtain the safe-harbor benefits of 3 U.S.C. § 5, Justice BREYER's proposed remedy—remanding to the Florida Supreme Court for its ordering of a constitutionally proper contest until December 18—contemplates action in violation of the Florida election code, and hence could not be part of an "appropriate" order authorized by Fla. Stat. § 102.168(8) (2000).

It is true that this statement assumes that Florida law hadn't changed between December 11 and December 12, and it assumes that the December 11 opinion meant what it appeared to say. But this statement does not purport to *forbid* the Florida court from concluding on remand that the U.S. Supreme Court had misinterpreted the statements it made on December 11. The Supreme Court's statement, for that matter, does not purport to forbid the Florida court from overruling its own December 11 interpretation of Florida law.

Thus, as a legal matter, the Florida court was indeed left free to order the sort of recount that Justices Souter and Breyer suggested. It is no doubt true that the Supreme Court's failure to make this fact explicit left many readers with the impression that the Court did not "want" to see another attempt at a recount. And it may even be true that the Justices anticipated this effect. But the Court had no legal duty to remind the Florida judges of their power to interpret, or reinterpret, Florida law.

Gore's lawyers reportedly drafted a brief for the Florida court making exactly this argument, though a political decision was made not to file it.[7] And, unlike the law professors who have stubbornly refused to recognize that the Supreme Court said exactly what it said, and not something else, two of Gore's lawyers have publicly acknowledged that the Court's opinion did *not* foreclose the Florida court from ordering a new recount. David Boies acknowledged this in response to a question from the audience at a Cardozo Law School symposium on April 26, 2001. And Ronald Klain made a similar acknowledgment in response to a question that I posed to him at the Federalist Society's National Lawyers Convention on November 17, 2001.[8] Both of them also indicated that they believed (what I think it entirely reasonable to believe) that the Florida court would have been unlikely to take advantage of its power to order a new recount, but that is very different from claiming that the Supreme Court had taken this power away.

It is a sad commentary on the state of legal academia that these two politically active practicing lawyers—who lost their case, let's recall—have been able and willing to acknowledge a plain and important truth that has been mysteriously invisible to so many prominent law professors. In the end, there is no good reason for the Senate to treat President Bush's Supreme Court nominees any worse than those of other Presidents. But there may be a good reason for the Senate to exercise a great deal of caution in dealing with law professors who claim to offer expert and disinterested legal advice. Especially when they puff themselves up as guardians of the "rule of law."

A "Political Question"?

A separate theme in the Ackerman volume is that the Supreme Court should never have decided *Bush v. Gore* at all. This theme takes two forms: a legal argument and a kind of "judicial restraint" argument.

The legal argument is presented by the other conservative represented in this volume, Steven Calabresi. The overall theme of his essay is that our culture has become too willing to accept judicial intervention in the political process, and that the public was regrettably content to let state and federal judges decide who would become president. This is an important point. During the 2000 controversy, there did seem to be remarkably few public challenges to the assumption that the courts should have the final word on the out-

come of the election. (*But see* Nelson Lund, Supreme Court's Not the Last Word, New York Post, December 4, 2000, at 31; Nelson Lund, Courts Don't Own the Law, New York Post, November 20, 2000, at 29.) Professor Calabresi goes astray, however, when he says that it is "quite clear-cut" that *Bush v. Gore* was legally nonjusticiable under the applicable precedents.

Professor Calabresi cites two cases. First, in *(Walter) Nixon v. United States* (1993), the Court held that a challenge to the Senate's conviction of an impeached judge was nonjusticiable because the Constitution left the Senate to decide how to conduct trials of impeachment. This decision might be a relevant precedent if *Bush v. Gore* had overturned a decision that *Congress* had made in the exercise of its Twelfth Amendment powers. *Bush v. Gore*, however, neither overturned any decision by Congress nor imposed any limits on Congress' prerogatives under the Twelfth Amendment.

Professor Calabresi next turns to *Baker v. Carr* (1962). Ironically, it is this case that first held vote-dilution claims (the same kind of claim at issue in *Bush v. Gore*) to be justiciable. Professor Calabresi, however, relies on a different part of Justice Brennan's opinion. In dictum, the Court said that all of the cases previously found to be nonjusticiable contained at least one of six features. These features were described in very general terms, and Professor Calabresi argues that they can all be found in *Bush v. Gore*. Whatever the merits of his analysis may be as an abstract matter, however, *Baker*'s dictum was irrelevant in *Bush v. Gore* because the Court had previously *held* that challenges to a state's method of choosing presidential electors *are justiciable*.

In *McPherson v. Blacker* (1892), the Court reviewed a challenge to Michigan's use of electoral districts to choose presidential electors. The Court held:

> It is argued that the subject-matter of the controversy is not of judicial cognizance, because it is said that all questions connected with the election of a presidential elector are political in their nature; that the court has no power finally to dispose of them; and that its decision would be subject to review by political officers and agencies, as the state board of canvassers, the legislature in joint convention, and the governor, or, finally, the congress.
>
> But the judicial power of the United States extends to all cases in law or equity arising under the constitution and laws of the United States, and this is a case so arising . . . .
>
> As we concur with the state court, its judgment has been affirmed; if we had not, its judgment would have been reversed. In either event, the questions submitted are finally and definitely disposed of by the judgment which we pronounce, and that judgment is carried into effect by the transmission of our mandate to the state court.[9]

The Court went on to resolve several constitutional questions, including questions arising under the Fourteenth Amendment, the same constitutional provision invoked in *Bush v. Gore*.

Professor Calabresi does not discuss *McPherson v. Blacker*. But its holding was well-known to all the Justices and all the litigants in *Bush v. Gore*. Only a few days before that decision, the Supreme Court had *unanimously* relied on *dicta* in *McPherson* when it vacated an earlier decision of the Florida Supreme Court in a different case arising from the disputed election.[10] None of the parties and none of the Justices could seriously have denied that the *McPherson holding* applied in *Bush v. Gore*. And none of them did.

Perhaps aware of the futility of maintaining that *Bush v. Gore* was nonjusticiable under the governing precedents, several other contributors to this volume contend that the Court exercised bad judgment in agreeing to review the case. Although their arguments take somewhat different forms, the most common version essentially argues that *Bush v. Gore* is just one more manifestation of the Rehnquist Court's outrageous "activism." This Court does not have sufficient respect for democratic institutions, we are told, and the five Justices in the *Bush v. Gore* majority simply repeated an offense of which they have been habitually guilty, especially in that notorious series of federalism decisions that I referred to earlier.

Most members of the Federalist Society are probably very tired of being lectured to by the left on the meaning of "true conservatism." We've all been taunted repeatedly with the one-way ratchet that requires "genuinely conservative" courts to devote themselves to the preservation of Warren and Burger Court decisions that overturned centuries of precedent and countless decisions by elected officials throughout the nation. I guess we're now going to have to get accustomed to hearing another variation on this theme: that a few small and hesitant efforts by the Court to identify the Constitution's limits on federal legislative power (few of which have overturned any judicial precedents at all) somehow manifest a hubristic contempt for democracy.

In any event, whatever validity there may be in the left's objections to some of the Court's recent federalism decisions, it takes a special kind of chutzpah to find contempt for democratic institutions in *Bush v. Gore*. This decision did not overturn any decision by any elected body. Instead, it invalidated an order issued by a subordinate *court*. During the election dispute, moreover, that subordinate court had persistently refused to defer to Florida's elected Secretary of State and to decisions by elected officials on county canvassing boards. This subordinate court had also dismissed the work of the Florida legislature as "technical statutory requirements," and used its "inherent" powers to issue orders that the legislature never authorized. Nor did *Bush v. Gore* prevent the Florida legislature from intervening in the election dispute, or tell the U.S. Congress that it must stay out of the dispute. Accusing the *Bush v. Gore* Court of contempt for democracy is akin to claiming that governmental suppression of political speech during election campaigns advances the values of the First Amendment.

Conclusion

The unanimity with which the left has condemned *Bush v. Gore* was predictable, for it is consistent with an ingrained tradition of evaluating legal decisions on the basis of their political effects. And the overwhelming dominance of the left in American law schools all but guaranteed that the Court would be vilified by the professoriate for its decision in this case.

What is surprising is how many prominent conservative professors have rushed to condemn the Court's legal analysis. It is actually something of a coup for Professor Ackerman to have found in Professor Fried one academic unwilling to do so, for he is very unusual in this respect. Some conservatives have dismissed the equal protection holding out of hand, though none of them has explained why it is so obviously wrong. Others have criticized the remedial part of the opinion, though none of them has shown that the Court actually did forbid the Florida court to attempt a constitutionally adequate recount on remand. Some have invoked the political-question doctrine, though without confronting *McPherson*. Others have argued that the decision was politically ill-advised, though without explaining why the Court should have taken political considerations into account at all. It is true that some of these conservatives have defended the *result* in *Bush v. Gore*, but they have often done so on political grounds that are not much more than mirror images of the left's political objections to the decision.

The Federalist Society was founded twenty years ago to promote an alternative to the left's politicized approach to legal analysis. The collection of essays reviewed here may serve as a reminder of why the Society came into existence. But the academic right's response to *Bush v. Gore* should call into question our prospects for success. The Court could easily have ducked this case, and thereby saved itself a lot of grief. Instead, five Justices courageously applied the law without regard to the political abuse that they had to know would soon be aimed their way, just as we've been saying they should for the past two decades. When you look at what they've gotten for their trouble, you have to wonder how long they can be expected to keep it up.

Footnotes

[1] Nelson Lund, *The Unbearable Rightness of Bush v. Gore*, 23 Cardozo L. Rev. 1219 (2002).

[2] "Undervotes" are ballots on which a counter did not detect any choice for the office of President. Similarly, "overvotes" are ballots on which a counter detected more than one choice for President, and thus registered no vote.

[3] Professor Fried invited me to comment on a prepublication draft of his chapter, and his chapter refers approvingly to my Cardozo Law Review article.

[4] Palm Beach Cty. Canvassing Bd. v. Harris, 772 So.2d 1273, 1289 (2000); *id*. at 1285-86 & n. 17; *id*. at 1290 n.22; *id*. at 1291. The Florida court had repeatedly made the same point in its initial opinion in the case as well. See 772 So. 2d 1220, 1237, 1239, 1239-40.

[5] 772 So.2d at 1290 n.22 (emphasis added).

[6] 772 So.2d at 1248.

[7] Washington Post Political Staff, *Deadlock: The Inside Story of America's Closest Election* 233-35 (2001).

[8] See 3 ENGAGE: THE JOURNAL OF THE FEDERALIST SOCIETY'S PRACTICE GROUPS 80-81 (August 2002).

[9] 146 U.S. 1, 23-24 (1892).

[10] Bush v. Palm Beach Cty. Canvassing Bd., 531 U.S. 70 (2000).

The Rule of Lawyers: How the New Litigation Elite Threatens America's Rule of Law by Walter K. Olson

By D. Eric Schippers

"What has happened is that the legislatures ... have failed," boasted trial lawyer John Coale to the *New York Times.* "Congress is not doing its job [and] lawyers are taking up the slack."

While Mr. Coale was referring, in this instance, to the legal war against the tobacco industry, the quote is much more symbolic of how the trial bar views its role in society. With an unlimited amount of money, well-heeled judicial and political allies, an adoring press and an endless stream of industries to wage war on, the nation's new "litigation elite" sees itself as "rescuing the process of lawmaking from the lawmakers," according to Walter K. Olson in *The Rule of Lawyers*.

A senior fellow at the Manhattan Institute and author of *The Litigation Explosion*, Olson serves up an eye-opening, jaw-dropping, behind-the-scenes look at how the self-anointed "Fourth Branch" has managed to infiltrate every corner of America's legal and political landscape. The author paints in lurid detail an incestuous picture of the trial lawyers' well rehearsed "three prong" strategy comprised of legal, political and public relations efforts, bolstered by open checkbooks, lies, deceit and, dare we say, extortion.

Starting with the $246 billion tobacco settlement, *The Rule of Lawyers* covers the big-city suits against gun manufacturers, the spurious silicone breast-implant affair and the past and ongoing asbestos suits, among others. In each case, Olson exposes the trial bar's dirty tricks-of-the-trade and explains how lawyers were able to manipulate the legal and political systems to bring down entire industries and force the largest redistribution of wealth ever seen in this country.

To understand the origins of stratospheric class action and personal injury suits now regularly splashed across newspaper front pages and trumpeted on nightly "newsmagazine" shows, Olson takes us back to the 1970s, the beginning of the American legal establishment's "love affair with the lawsuit."

While much of the nation was preoccupied with the aftermath of Vietnam and Watergate, not to mention the ubiquitous disco ball, mood rings and the pet rock, a team of lawyers, inspired by Ralph Nader, was busy at work hashing out novel legal theories to support the proliferation of class action lawsuits against American businesses.

Drawing up a laundry list of perceived harms they claimed could be traced back to the doorstep of corporate America, liberal activist lawyers put forth what one might consider a rough blueprint for today's explosion of mass tort litigation. Everything from "junk food" and alcohol consumption, to air and noise pollution made the list.

By the mid-1970s, many of the old barriers to big ticket litigation had been, or were in the process of being, knocked down. "Rules of procedure were drastically liberalized to make it easier to sue and harder to get a suit dismissed," explains Olson. "Notice pleading" allowed lawyers to "sue first and then begin rummaging around to see whether they had a case." Fishing expeditions were greatly aided by the liberalization of pretrial discovery. "Long Arm" jurisdiction made it easier for lawyers to venue shop. And, in 1977, the U.S. Supreme Court affirmed the constitutional right of lawyers to advertise.

Those important ingredients, combined with new developments in product-liability law in the late 1960s — which provided that "companies could (retroactively) be sued for failing to warn about harmful characteristics of the products they sold" — provided a winning recipe for the trial lawyers to launch their assault on the asbestos industry and others.

By 2001, the wacky legal theories of Ralph Nader's acolytes from a bygone polyester era had officially made a comeback. Suddenly, Olson explains, the notion of "universal enterprise liability — in which Schick and Gillette would pay for your razor nicks, Toyota for your bad driving skills, and Baskin-Robbins for the extra pounds you owed to its Jamoca Almond Fudge — was now the stuff of respectable discourse."

Today, as the line between class action and personal injury claims continues to blur, lawsuits have been filed against McDonald's on behalf of customers who claim the company's "junk food" made them fat. Trial lawyers are targeting the managed-care industry, lead paint manufacturers and pharmaceutical makers over drug pricing; some have even gone after cell phone makers for an unsubstantiated link between cell phones and brain cancer.

And what benefit do the plaintiffs receive from actions such as these? Generally they might end up with "non-monetary relief" in the form of a redeemable coupon, or in some cases, nothing at all. Olson points out a well-known class action suit in Alabama in the mid-1990s against a mortgage lender over escrow practices. In that case, many of the class members were awarded benefits that were "actually smaller than the legal fees deducted from their accounts, leaving them poorer in various instances by $100, $150, or more." As for the trial lawyers, their relief is frequently hard to fit on a calculator.

While the trial lawyers continue to prowl for the next big score, *The Rule of Lawyers* provides valuable ammunition for those who march under the banner of legal reform. Perhaps more important, it serves as a wake-up call to those who have long turned a blind eye and a deaf ear to the crisis of "jackpot justice" in our courts and the growing influence of trial lawyers in public office.

As trial lawyer John Coale boasted to *The New Yorker* in regard to lawsuits filed against gun manufacturers: "[We] have the resources to start a war instead of taking little pot-shots ... Well, we've started a war."

With former trial lawyer-turned-Senator John Edwards throwing his hat in the ring for President, it looks as if the trial bar is now in the market for a Commander-in-Chief.

Grace Periods and the European and International Patent Law: Analysis of Key Legal and Socio-Economic Aspects by Joseph Straus

By F. Scott Kieff

This monograph, published as volume 20 in the Max Plank Institute's series entitled International Review of Industrial Property and Copyright Law (also known as "IIC"), is one of the studies commissioned by the European Patent Organization pursuant to a mandate issued at the Intergovernmental Conference of the member states of the European Patent Organization held from June 24-25, 1999, on the reform of the patent system in Europe to examine whether European patent law should provide a so-called "pre-filing grace period." The central requirement for patentability that is common across the patent systems of the world is the requirement of novelty over the prior art – to be patentable, the subject matter of the patent must not have been in the prior art. But, not every patent system in the world defines the scope and content of the prior art in the same way. More specifically, the pre-filing grace period is one major area in which the patent systems of the world substantially diverge when determining what is treated as prior art. For example, in the United States patent system, disclosure of an invention by the inventor does not destroy patentability if it is made within one year before the patent application was filed. Such a disclosure is not treated as being within the prior art. In contradistinction, such disclosure may destroy patentability under the European Patent Convention ("EPC"). It may be treated as being within the prior art.

Straus provides an excellent resource for anyone interested in a condensed volume on the present positive law, policy, and history of the use of grace periods across the major patent systems of the world, with a particular emphasis on Europe. After introductory and summary materials, he begins with a review of the history of grace periods under each of the major world patent systems. He then discusses recent European proposals for the introduction of different grace periods. Next, he reviews the various arguments for and against grace periods as well as the empirical evidence collected over the years from systems that have a grace period and those that do not. He concludes by recommending that the EPC's contracting states adopt a grace period, including several important, and specific, implementation details.

Questions about the pre-filing grace period are of great importance to anyone interested in either patents or in the disclosure of new technologies. A no grace period regime may provide incentives for decreased rate of disclosure of new technologies and a decrease in the over-all value of patents. In contrast, a grace period regime may decrease incentives for early investment in using new technologies for fear they may later become subject to a patent application that might in time issue as a valid patent. The complexity of this analysis only increases when any one patent system is studied in the context of a world comprising numerous patent systems, including both those with a grace period and those without one. The net impact of the various theoretical costs and benefits of a pre-filing grace period remains a topic of real debate in the academic and policy literatures.

Straus' discussion brings these competing views into sharp focus, with good citations to both arguments and facts. Of particular note is his careful collection of court cases in which judges effectively gave grace period treatment under particular facts despite the absence of national statutory law permitting a grace period. Also noteworthy is his presentation of empirical data about the use of grace periods under patent systems in which they are provided by statute. In addition, he provides a very good overview of the normative arguments for and against grace period adoption and tests each major view against the empirical data.

The resulting monograph offers the reader much more than some sound recommendations for a single patent system – the EPC. This conveniently short work offers a surprisingly rich collection of historical, normative, and empirical perspectives on a policy question that is important for every patent system. In so doing, this work would be of particular use to commentators studying present and past patent systems; to practitioners forced to litigate over the prior art effect of a pre-filing disclosure, especially in countries that do not have a statutory grace period; and to participants in the on-going policy and treaty debates on the use of a statutory grace period, such as the pending negotiations on the Substantial Patent Law Treaty at the World Intellectual Property Organization.