Texas Law Review

May 2011 Vol. 89 No. 6 Pages 1247 to 1515

Texas Law Review (ISSN 0040-4411) is published seven times a year—November, December, February, March, April, May, and June. The annual subscription price is $47.00 except as follows: Texas residents pay $50.88 and foreign subscribers pay $55.00. All publication rights are owned by the Texas Law Review Association. *Texas Law Review* is published under license by The University of Texas at Austin School of Law, P.O. Box 8670, Austin, Texas 78713. Periodicals Postage Paid at Austin, Texas, and at additional mailing offices.

POSTMASTER: Send address changes to The University of Texas at Austin School of Law, P.O. Box 8670, Austin, Texas 78713.

Complete sets and single issues are available from WILLIAM S. HEIN & CO., INC., 1285 Main St., Buffalo, NY 14209-1987. Phone: 1-800-828-7571.

Single issues in the current volume may be purchased from the *Texas Law Review* Publications Office for $15.00 per copy plus shipping. Texas residents, please add applicable sales tax.

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Texas Law Review

Volume 89 Number 6 May 2011

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Texas Law Review

Volume 89, Number 6, May 2011

ARTICLES

BOOK REVIEW

BOOK REVIEW SYMPOSIUM

NOTES

Articles

Amicus Briefs and the Sherman Act: Why Antitrust Needs a New Deal

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Power to interpret the Sherman Act, and thus power to make broad changes to antitrust policy, is currently vested in the Supreme Court. But re-evaluation of existing competition rules requires economic evidence, which the Court cannot gather on its own, and technical economic savvy, which it lacks. To compensate for these deficiencies, the Court has turned to amicus briefs to supply the economic information and reasoning behind its recent changes to antitrust policy. This Article argues that such reliance on amicus briefs makes Supreme Court antitrust adjudication analogous to administrative notice-and-comment rulemaking. When the Court pays careful attention to economic evidence and arguments presented in amicus briefs, it moves the process away from a traditional Article III case or controversy and towards rulemaking under the Administrative Procedure Act (APA) where any interested party can influence the decision. In doing so, the Court sacrifices some of the epistemological benefits of Article III's standing requirements. In the case of antitrust, those costs are probably outweighed by how much the Court benefits from hearing the amici's economic arguments. But while the Court's hybrid rulemaking—quasi-administrative and quasi-judicial—may improve upon the traditional judicial model, it cannot realize the full benefits of APA rulemaking. The awkwardness of using amicus curiae briefs like comments on a rulemaking suggests a more dramatic shift in authority over the Sherman Act is necessary. Power to interpret the Act in the first instance should go to an administrative agency.

Introduction

The Sherman Act's condemnation of "[e]very . . . combination . . . in restraint of trade" and "[e]very person who shall monopolize" is so unfocused that whoever is in charge of its interpretation has broad leeway to

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shape economic policy.[1] That duty falls on the courts, who must sort out the details of what practices and pricing schemes amount to unreasonably anticompetitive behavior. As in other federal statutory cases, the Supreme Court has the final word on the Act's meaning. But because the Sherman Act is so vague and so broad, the Court's task in developing specific rules under it is more like constitutional interpretation than statutory interpretation.[2] Like constitutional law, the modern law of the Sherman Act has been developed through the common law process: case-by-case adjudication of disputes between particular parties, over decades of refinement, and even reversals.[3]

But making law under the Sherman Act differs from deciding typical common law questions. In defining contract or property rights, Justices can reason primarily by analogy, informed by intuition and broad considerations of morality and efficiency and constrained, of course, by precedent. But the modern antitrust imperative demands technical and quantitative reasoning.[4] Antitrust rules must be designed to maximize consumer welfare through economically efficient competition.[5] For this kind of technical thinking, the Justices need help. In the Supreme Court, help with understanding economic theory and interpreting empirical data on competition (or, more often, its absence) comes from amicus briefs, which often present more economic arguments than the parties' briefs.[6] Unsurprisingly, these amicus briefs receive considerable attention from the Court and influence its opinions.[7]

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1. 15 U.S.C. §§ 1–2 (2006).

2. William Howard Taft wrote that the words of the Sherman Act were written "with the intention that they should be interpreted in the light of common law, just as it has been frequently decided that the terms used in our federal Constitution are to be so construed." WILLIAM HOWARD TAFT, THE ANTI-TRUST ACT AND THE SUPREME COURT 3 (1914).

3. Frank H. Easterbrook, *Vertical Arrangements and the Rule of Reason*, 53 ANTITRUST L.J. 135, 136–37 (1984).

4. *See* Abbott B. Lipsky, Jr., *Antitrust Economics—Making Progress, Avoiding Regression*, 12 GEO. MASON L. REV. 163, 165 (2003) ("[T]he rapid assimilation of microeconomics into antitrust thinking makes almost every antitrust controversy an exercise in microeconomic analysis.").

5. *See* Daniel A. Crane, *Technocracy and Antitrust*, 86 TEXAS L. REV. 1159, 1212 (2008) ("Within the last few decades a broad consensus has emerged that consumer welfare and economic efficiency are the overriding, if not exclusive, goals."); Easterbrook, *supra* note 3, at 138 (stating that the Court views antitrust laws as a consumer-welfare prescription).

6. *See, e.g.*, Brief of the Commonwealth of Virginia and Eight Other States as Amici Curiae in Support of the Petitioners at 3–6, Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc., 129 S. Ct. 1109 (2009) (No. 07-512), 2008 WL 4154540 (arguing that the Ninth Circuit's decision harms consumers and protects competitors rather than competition); Brief of Amici Curiae Economists in Support of Petitioners, Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007) (No. 05-1126), 2006 WL 2506633 (discussing how the parallel-behavior-is-enough standard would increase economic costs).

7. *See generally* Stephen Calkins, *The Antitrust Conversation*, 68 ANTITRUST L.J. 625 (2001); Stephen Calkins, *Supreme Court Antitrust 1991–92: The Revenge of the Amici*, 61 ANTITRUST L.J. 269 (1993).

In relying so heavily on arguments from nonparties, the Court mimics the procedures used by other branches of government to make decisions involving technical inputs and reasoning. When an agency regulates complicated systems, like energy markets or the environment, it solicits third-party input through notice-and-comment rulemaking.[8] Similarly, the Court looks to amici to parse difficult theoretical arguments and present empirical data about competition economics. Friends of the court—trade organizations, companies, and groups of professors—use amicus briefs to solicit a particular rule from the Court, in the same way that those same third parties lobby agencies through comments on rulemaking. And like an administrative agency, the Court seems to feel some obligation to respond to the amici's arguments in their final decision.

The Court is certainly right to open the conversation to all affected parties, including amici who have economic arguments and data but not Article III standing to join the suit. The Court is better off with the amici than without them—the informational benefits of open amicus participation outweigh the costs of relaxing justiciability requirements to give third parties such a powerful voice in the litigation.[9] But to be complacent with the Court's current reliance on amici ignores a better solution.

Instead of forcing the Court to approximate agency decision making by relying on amicus briefs, we should endow an antitrust agency with authority to make Sherman Act rules in the first instance.[10] Such an agency could go further than the Court can in soliciting expert opinions, conducting studies, and collecting data. It would have the advantage of economic expertise. And it would be accountable in a way that the Court is not, since its rules and decisions would be subject to judicial review.

This Article proceeds in five parts. In Part I, I summarize the history of amicus participation and justifications for its use in technical areas of law like antitrust. Part II shows that in relying on amici, the Court acts like an agency—but not quite. This Part explains the similarities and important differences between the antitrust Supreme Court and a proper rulemaking agency, arguing that the Court's hybrid solution sacrifices some of the benefits of Article III's cases and controversies requirement while failing to fully realize the benefits of Administrative Procedure Act (APA) rulemaking. Part III provides two recent examples of Supreme Court rulemaking in antitrust: *Pacific Bell Telephone Co. v. Linkline*

8. 5 U.S.C. § 553 (2006).

9. *See* Calkins, *The Antitrust Conversation*, *supra* note 7, at 628–38 (highlighting the ways in which amici's arguments have advanced antitrust doctrine).

10. For the case for administrative antitrust decision making, see Crane, *supra* note 5, at 1212–14 (discussing three features of modern antitrust that make it particularly suited to technocracy).

Communications, Inc.[11] and *Leegin Creative Leather Products, Inc. v. PSKS, Inc.*[12] In these cases, the Court made mistakes that were at least partially attributable to its reliance on amicus briefs for economics. Finally, in Section IV, I take up the idea that an agency should be endowed with norm-creation authority over antitrust policy. I argue that where amicus briefs fail, administrative procedures are more likely to succeed. Part V concludes.

I. The Court's Use of Amici in Technical Cases

The Court's heavy reliance on amicus briefs is by no means unique to antitrust; almost no case is briefed before it without some help from a "friend."[13] And the influence of amici on Supreme Court decisions is significant.[14] But a narrow reading of Article III's cases and controversies requirement would make this participation of amici impossible, since under that clause only parties with a justiciable dispute can petition a court for redress. How did amicus briefs come to their current prominence, and what do we know about their influence on the Justices?

A. The Rise of the Amicus Brief in the Twentieth Century

Article III limits the Supreme Court's jurisdiction to "cases" and "controversies."[15] To effectuate this requirement, the Court has created the doctrines of standing, ripeness, mootness, and personal jurisdiction, to name only a few. But amicus participation has opened a constitutional back door to interested third parties who want to influence a judicial decision but lack standing or injury.[16] Although the constitutionality of amicus briefs is uncontroversial,[17] at times the Court has seemed ambivalent about their proper role.

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11. 129 S. Ct. 1109 (2009).

12. 551 U.S. 877 (2007).

13. Ninety-five percent of cases filed before the Supreme Court between 1996 and 2003 included at least one amicus brief. Omari Scott Simmons, *Picking Friends from the Crowd: Amicus Participation as Political Symbolism*, 42 CONN. L. REV. 185, 193 (2009).

14. *See* Joseph D. Kearney & Thomas W. Merrill, *The Influence of Amicus Curiae Briefs on the Supreme Court*, 148 U. PA. L. REV. 743, 828–30 (2000) (concluding that amicus briefs do have an impact on the Court, particularly when they come from major institutional litigants or the Solicitor General).

15. U.S. CONST. art. III, § 2.

16. *See* Michael K. Lowman, *The Litigating Amicus Curiae: When Does the Party Begin After the Friends Leave?*, 41 AM. U. L. REV. 1243, 1280–82 (1992) (warning that expanded use of the amicus device allows would-be litigants to circumvent the standing requirements of Article III).

17. Some scholars have gone as far as to find a constitutional right to participate as amicus curiae. Professor Ruben J. Garcia locates the right in the First Amendment's prohibition on governmental interference with the "right of *the people* . . . to petition the government for a redress

In 1939, the Supreme Court crystallized procedures for filing amicus briefs in what is now United States Supreme Court Rule 37.[18] It allowed amicus briefs to be filed with the consent of all parties, or when that was denied, the consent of the Court.[19] Governmental representatives—state attorneys general and the Solicitor General—could file in any case.[20] In the decades after promulgating this rule, the Court was inundated by "propagandistic" briefs in cases involving the House Un-American Activities Committee and the Rosenbergs' espionage trial.[21] Although the Court did not materially alter the rules, it responded by adopting an "unwritten policy of denying virtually all motions for leave to file as amicus curiae" when the parties denied consent.[22]

But again the Court changed its mind, and by the 1960s its attitude towards amicus participation was laissez-faire. Today, leave to file an amicus brief is granted as a matter of course. Formally, the rules have not changed—an amicus must get permission from either the parties or the Court to file a brief.[23] But since the Court's "current practice in argued cases is to grant nearly all motions for leave to file as amicus curiae when consent is denied by a party," in practice amici face an open door.[24] Thanks to this permissive attitude, at least in part, the number of amicus briefs filed at the Supreme Court rose 800% between 1946 and 1995.[25]

The Court's attitude towards third-party participation in suits loosely tracked its feelings about another affront to Article III: administrative agencies.[26] In 1937, the same year it codified rules about amicus participation, the Supreme Court upheld the constitutionality of the

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of grievances." Ruben J. Garcia, *A Democratic Theory of Amicus Advocacy*, 35 FLA. ST. U. L. REV. 315, 336–38 (2008) (quoting U.S. CONST. amend. I) (emphasis added).

18. SUP. CT. R. 27.9, 306 U.S. 687, 708–09 (1939) (repealed 1954); *see also* Kearney & Merrill, *supra* note 14, at 761 n.54 (chronicling the Supreme Court's changes to the rules governing amicus briefs).

19. *Id.*

20. Kearney & Merrill, *supra* note 14, at 761–62.

21. *See* Samuel Krislov, *The Amicus Curiae Brief: From Friendship to Advocacy*, 72 YALE L.J. 694, 709–11 (1963) (describing the increasing irritation with amicus participation building during the 1940s and reaching "an apex of notoriety and criticism" in the early 1950s, due in large part to lobbying from liberal groups in cases involving communism).

22. Kearney & Merrill, *supra* note 14, at 763.

23. SUP. CT. R. 37.3.

24. Kearney & Merrill, *supra* note 14, at 762; *see also* Ed R. Hayden & Kelly Fitzgerald Pate, *The Role of Amicus Briefs*, 70 ALA. LAW. 115, 118 (2009) (asserting that the U.S. Supreme Court has traditionally been open to amicus curiae briefing); Simmons, *supra* note 13, at 195–96 (commenting on the Supreme Court's allowance of virtually unlimited amicus participation).

25. Kearney & Merrill, *supra* note 14, at 749.

26. Professor Samuel Krislov has traced the rise of amicus advocacy in part to the "emergence of administrative agencies." Krislov, *supra* note 21, at 706. For a more recent observation along these lines, see Simmons, *supra* note 13, at 193.

National Labor Relations Act,[27] a statute that gave broad authority to an agency to adjudicate controversies. Described by one commentator as the Court's "large-scale retreat from policing the structural boundaries of congressional power," the opinion favored the nemesis of anti-New Dealers: the NLRB.[28] And just as the 1940s saw a clamping down on amicus briefs, so the '40s witnessed the reining in of agency power in the form of the Administrative Procedure Act.[29] Again the Court's attitude reversed, and today it places minimal limits on agency action and effectively none on amicus participation.

B. How the Court Uses Amicus Briefs

What accounts for the liberalizing of judicial attitudes towards amicus participation? The Court's increased interest in amicus argument coincided with the rise of legal realism,[30] which rejected the idea that judges discover law as a scientist discovers physical properties of the universe. As the Court began to imagine its role to be policy making, access to information about the effects of that policy became necessary to make rules responsive to social needs.[31] In *Muller v. Oregon*,[32] Louis Brandeis filed an amicus brief citing social scientific data about women in the workforce that proved influential on the Court.[33] The case challenged the constitutionality of limitations on work hours for women, and the Court found support in studies cited in Brandeis's brief indicating physiological differences in women that the law could take notice of without violating equal protection.[34]

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27. NLRB v. Jones & Laughlin Steel Corp., 301 U.S. 1, 49 (1937).

28. GARY LAWSON, FEDERAL ADMINISTRATIVE LAW 192 (4th ed. 2007).

29. *See* George B. Shepherd, *Fierce Compromise: The Administrative Procedure Act Emerges from New Deal Politics*, 90 NW. U. L. REV. 1557, 1678–79 (1996) (describing the APA as the result of years of conservative attempts to curtail the power of New Deal administrative agencies).

30. Simmons, *supra* note 13, at 194–95.

31. Perhaps this is why Justices Frankfurter and Black, the former preferring an early form of judicial minimalism and the latter more willing to "depart from a role of narrowly resolving adversary disputes," disagreed about the proper role for amicus briefs. Krislov, *supra* note 21, at 717. Samuel Krislov, writing in 1963, traced the rise of amicus advocacy in part to the "emergence of administrative agencies." *Id.* at 706. For further discussion of the Frankfurter–Black debate about amicus curiae, see Simmons, *supra* note 13, at 195.

32. 208 U.S. 412 (1908).

33. Brief for the State of Oregon, Muller v. Oregon, 208 U.S. 412 (1908) (No. 107), 1908 WL 27605. Justice Brandeis's role in the litigation was ambiguous, since he appeared for the State of Oregon, believing that "'the status of appearing as an official participant on behalf of the state seemed . . . an important element of strength for the defense.'" Krislov, *supra* note 21, at 708 (quoting LOWELL MASON, THE LANGUAGE OF DISSENT 248 (1959)). It was not until 1916 that Frankfurter observed that "Brandeis' role was essentially that of amicus curiae." *Id.* at 708.

34. *See* Garcia, *supra* note 17, at 340 n.150.

After Brandeis's success in *Muller*, amici increasingly filed briefs citing social science data in favor of a legal outcome.[35] These briefs became known as "Brandeis Briefs."[36] Perhaps the most famous use of social scientific data in Supreme Court policy making is the brief submitted by the NAACP in *Brown v. Board of Education*.[37] The brief cited a study as empirical support for the idea that school children were injured by segregation in terms of academic advancement and self-esteem. The Court used the brief and the study to bolster its opinion that was ostensibly based on purely legal interpretations of equal protection, a notion not traditionally thought to have foundations in social science.[38]

The empirics of Brandeis Briefs suggest that the Court pays attention to amici because they provide good informational inputs for its policy choice. Indeed, legal scholars have confirmed this hypothesis. In their empirical study of amicus briefs before the Court, Professors Joseph Kearney and Thomas Merrill tested the influence of amici against three models of judicial behavior—the legal model, the attitudinal model, and the interest-group model.[39] The legal model suggests that judges are interested in getting the case right, and the authors hypothesized that a judge operating under the legal model "should be receptive to 'Brandeis Brief'-type information that sheds light on the wider social implications of the decision."[40] While their observations about the influence of amicus briefs on the Court suggested some support for the attitudinal and interest-group models, on the whole they interpreted their "results as providing the most support for the legal model."[41]

Anecdotal evidence for the informational value of amicus briefs abounds. Justice Breyer has been an outspoken advocate of the informational benefits of amicus participation in particularly complex areas of law and in questions that implicate technical or scientific issues.[42] Surveys of

35. *See* Ellie Margolis, *Beyond Brandeis: Exploring the Uses of Non-Legal Materials in Appellate Briefs*, 34 U.S.F. L. REV. 197, 203 (2000) (noting that the introduction of nonlegal material at the appellate stage "has been done since the early twentieth century, when Louis Brandeis submitted his brief in *Muller v. Oregon*").

36. *Id.* at 199 & n.12.

37. 347 U.S. 483 (1954).

38. *See* Margolis, *supra* note 14, at 230 (asserting that the Supreme Court relied on empirical studies that indicated segregation "generates a feeling of inferiority as to . . . status in the community that may affect . . . hearts and minds in a way unlikely ever to be undone" to support the decision in *Brown*).

39. Kearney & Merrill, *supra* note 12, at 748–49.

40. *Id.* at 778.

41. *Id.* at 816.

42. In a media interview, Justice Breyer said that amicus briefs containing technical information "'play an important role in educating judges on potentially relevant technical matters, helping to make us not experts but educated lay persons and thereby helping to improve the quality of our

judges, Justices, and clerks confirm that among the most helpful "briefs are those filed in technical cases by industry experts having a familiarity with the specialized legal issues at stake."[43] The more sensitive and complex the regulated system, the more help experts and professors can provide generalist judges. Systems like the environment and economic competition fall in this category.

But the informational model of amicus participation is not the only one with traction; amicus briefs can also signal to the Court the number and kind of supporters a rule has. And the courts do seem to be influenced by this aspect of amicus participation, lending support to the affected groups' model of judging under the influence of amici.[44] Some judges are highly critical of this use of amici. Judge Richard Posner has repeatedly rejected motions for leave to file as amicus curiae, saying that the amicus brief should not be a vehicle for groups to signal their political preference to the court.[45] In one instance denying such a motion, he said, "Essentially, the proposed amicus briefs merely announce the 'vote' of the amici on the decision of the appeal. But, as I have been at pains to emphasize in contrasting the legislative and judicial processes, they have no vote."[46] Judge Posner has also complained about another effect of using amicus briefs to register policy preferences: the irksome "me too" phenomenon that occurs when amici pile on briefs that do not introduce new information or arguments.[47]

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decisions.'" *Justice Breyer Calls for Experts to Aid Courts in Complex Cases*, N.Y. TIMES, Feb. 17, 1998, at A17.

43. Kelly J. Lynch, *Best Friends? Supreme Court Law Clerks on Effective Amicus Curiae Briefs*, 20 J.L. & POL. 33, 41 (2004); *see also* Luther T. Munford, *When Does the Curiae Need an Amicus?*, 1 J. APP. PRAC. & PROCESS, 279, 281 & n.14 (1999) (observing that expertise can be a benefit offered by amici and giving an example from the New Mexico Supreme Court involving the apportionment of water rights).

44. For defenses of this political use of amicus participation, see Garcia, *supra* note 17, at 317 ("The amicus brief is a form of speech and petition, to which the courts should give due consideration."), and Simmons, *supra* note 13, at 190 ("[T]he political symbolism of amicus curiae participation reassures the public . . . of the Court's democratic character.").

45. For a discussion of Judge Posner's attitude towards amicus participation and his hostility's influence on other federal judges, see Garcia, *supra* note 17, at 326–30.

46. Voices for Choices v. Ill. Bell Tel. Co., 339 F.3d 542, 545 (7th Cir. 2003).

47. *See* Ryan v. Commodity Futures Trading Comm'n, 125 F.3d 1062, 1063 (7th Cir. 1997) ("The vast majority of amicus curiae briefs are filed by allies of litigants and duplicate the arguments made in the litigants' briefs, in effect merely extending the length of the litigant's brief. Such amicus briefs should not be allowed. They are an abuse."). Ostensibly, Supreme Court Rule 37 allows only amicus filings that "bring[] to the attention of the Court relevant matter not already brought to its attention by the parties [that] may be of considerable help to the Court." But the trouble is getting someone to go through the briefs in order to determine whether it meets this standard, thereby defeating the time-saving aim of the rule. *See* Garcia, *supra* note 17, at 325. Professor Stephen Calkins takes a positive perspective on redundant amicus briefs, extolling their ability to provide "special emphasis" to an aspect of an antitrust case. Calkins, *The Antitrust Conversation*, *supra* note 7, at 638–43.

For better or worse, the Court does seem to be affected by signals of policy preferences from amici.[48] But Merrill and Kearney found that identity, not number, of a party's supporters had the strongest influence on the Court.[49] Unsurprisingly, Kearney and Merrill showed that among all amici, the Solicitor General had the strongest influence on the Court,[50] but states, the NAACP,[51] and the ACLU[52] all seemed to enjoy the Court's ear. And any amicus curiae can boost its credibility with the Court by taking a position contrary to its apparent interests or from teaming up with an odd bedfellow to file a brief jointly. When an amicus goes against the Court's expectation, it is harder for the Court to dismiss the amicus brief as self-interested lobbying.[53]

II. When the Court Uses Amici for Economic Arguments, It Acts Like an Agency . . . Almost.

When the Supreme Court relies on amici for economic arguments in deciding an antitrust case, it acts like an agency soliciting comments on a proposed rulemaking.[54] Interested parties—but not parties to a concrete, litigable dispute—are asked to present evidence and arguments relevant to a policy issue. Both decision makers consider the information they receive and justify their ultimate decisions against criticisms leveled in the comments. Seen in this way, Supreme Court antitrust adjudication begins to look more like administrative notice-and-comment rulemaking than it does a judicial appeal.

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48. *See* Garcia, *supra* note 17, at 340–41 ("Amicus briefs have played an important role in communicating the views of social movements to the courts in numerous cases.").

49. *See* Kearney & Merrill, *supra* note 14, at 801, 811 (finding that while the total number of briefs on a side was not correlated with success, briefs filed by the Solicitor General and other institutional filers significantly affected outcomes).

50. *Id.* at 803–04. For a broader discussion of the Solicitor General's participation as amicus curiae, see Simmons, *supra* note 13, at 211–14.

51. Lynch, *supra* note 43, at 50 (reporting that 11% of Supreme Court clerks responding to the survey said that the NAACP's amicus briefs "always receive closer attention"). The NAACP's influence with the Court has been long-standing. The group filed an amicus brief as early as 1915 in *Guinn v. United States*, 238 U.S. 347 (1915).

52. *Id.* at 49 (reporting that 33% of Supreme Court clerks responding to survey said that they gave the ACLU's amicus briefs more consideration).

53. *See* Calkins, *The Antitrust Conversation*, *supra* note 7, at 628–31 (discussing examples of "an important antitrust repeat playing tak[ing] an unpredicted position").

54. *Cf.* Garcia, *supra* note 17, at 338–40 (explaining that in cases involving administrative rules, amici briefs provide an opportunity for interested parties to comment on administrative rulemaking, and that amicus participation in statutory cases can perform a similar function in cases interpreting statutes).

A. Similarities

1. The procedures are the same.—Congress authorizes the Supreme Court to regulate competition by giving it the last word on what the Sherman Act means.[55] Thus, the Sherman Act is to the Supreme Court as an organic statute is to an administrative agency—both a mandate and a constraint. The Act's language is broad and imprecise; it is a significant delegation of authority.[56] And since a dozen petitions for certiorari raising antitrust issues are filed each year[57] and the Court takes only one or two of these,[58] it has some discretion in setting its antitrust agenda, if not quite the unfettered discretion an agency enjoys in considering areas for rulemaking under § 553 of the APA.[59]

The involvement of amici completes the metaphor. When the Supreme Court grants certiorari in an antitrust case, it announces its intention to allocate rights and resources under the broad mandate of the Sherman Act. This announcement is like an agency's notice of proposed rulemaking (NPR), with an important difference. In both cases, the decision maker invites those who believe they have a stake in the outcome to present evidence supporting their side. But when the Court grants certiorari, it announces merely its intention to resolve a dispute, not its proposed resolution.[60] The imprecision of the certiorari-as-NPR metaphor may have important implications since parties commenting on a rule making may have more information about the agency's regulatory inclination than an amicus does about the Court's.

Despite the imperfect fit, the similarities between certiorari and NPR are striking: like the comment period, the time between grant of certiorari and close of briefing gives third parties an opportunity to weigh in much

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55. *See* Nat'l Soc'y of Prof'l Eng'rs v. United States, 435 U.S. 679, 688 (1978) (explaining how Congress never intended to provide the full meaning of the Sherman Act but rather authorized the courts to give meaning to the statute by drawing on common law tradition).

56. *See* Arthur S. Miller, *Statutory Language and the Purposive Use of Ambiguity*, 42 VA. L. REV. 23, 23, 30 (1956) (explaining that Congress's use of ambiguous statutory language is purposeful in order to delegate interpretation authority to the courts).

57. *See* Thomas G. Hungar & Ryan G. Koopmans, *Appellate Advocacy in Antitrust Cases: Lessons from the Supreme Court*, 23 ANTITRUST 53, 53 (2009) ("From September 2002 to October 2008, 94 petitions were filed that presented issues of antitrust law . . . .").

58. *Id.* (stating that out of 94 petitions concerning antitrust law issues, "the Court granted certiorari in only ten, a rate of less than 11 percent").

59. *See* LAWSON, *supra* note 28, at 195–96 (describing the minimal restrictions on informal agency rulemaking under the APA).

60. In this way, the Court's grant of certiorari is more like an agency's announcement that a certain issue is on its agenda—these notices are published semi-annually in the *Unified Agenda of Federal Regulation*. Peter L. Strauss, *From Expertise to Politics: The Transformation of American Rulemaking*, 31 WAKE FOREST L. REV. 745, 761–62 (1996).

like the comment period in an administrative rulemaking. Without amici, the Court would be limited to considering two perspectives on the proposed economic policy. But with the benefit of amici, the Court can consider sometimes dozens of different perspectives on the issue, in the same way that the comment period allows agencies the benefit of many opinions and arguments about a rule.

Once the amici have spoken and the briefing period ends, the Court hears oral argument, makes its decision, and writes an opinion explaining and justifying the new antitrust rule. The opinion resembles the statement of basis and purpose that an agency is obliged to publish after issuing a final rule.[61] In fact, the drafters of the APA probably had judicial opinions in mind when they created the statement of basis and purpose requirement.[62]

Unlike the Court writing an opinion, an agency is required by law to respond to major objections in its statement of basis and purpose.[63] But even without this hard requirement, the Court's antitrust opinions often address counterarguments from amicus briefs. One might expect the Court to cherry-pick from the amicus briefs the arguments and data most supportive of their opinion and discuss only counterarguments that appear in the parties' briefs. But in recent antitrust jurisprudence, the Court has spent *more* time discussing the amicus briefs on the losing side than on the winning side. This suggests that the Court feels an agency-like responsibility to consider all the perspectives before it.

2. The players are the same.—Amicus curiae means "friend of the court," and indeed the original idea seemed to be that these third parties would be nonpartisan sources of information that might direct the court to the objectively correct decision.[64] That naïve view has given way to the realistic perspective—now taken for granted—that amici are more "friends of a party" than "friends of the court."[65] Although in formal filings the

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61. 5 U.S.C. § 553(c) (2006). For a discussion of the statement and purpose rule, see LAWSON, *supra* note 28, at 280–83.

62. *See* LAWSON, *supra* note 28, at 280 (comparing the statement and purpose rule to a judicial opinion).

63. Michael Abramowicz & Thomas B. Colby, *Notice-and-Comment Judicial Decisionmaking*, 76 U. CHI. L. REV. 965, 1023 (2009); *see also, e.g.*, Reytblatt v. U.S. NRC, 105 F.3d 715, 722 (D.C. Cir. 1997) ("An agency need not address every comment, but it must respond in a reasoned manner to those that raise significant problems.").

64. Stuart Banner, *The Myth of the Neutral Amicus: American Courts and Their Friends, 1790–1890*, 20 CONST. COMMENT. 111, 111 (2003). The term comes from Roman law, under which "the amicus, at the court's discretion, provided information on areas of law beyond the expertise of the court." Lowman, *supra* note 16, at 1248.

65. *See* Krislov, *supra* note 21, at 704 ("The Supreme Court of the United States makes no pretense of such disinterestedness on the part of 'its friends.' The amicus is treated as a potential litigant in future cases, as an ally of one of the parties, or as the representative of an interest not

amicus curiae moniker has remained, in opinion writing the Court has all but dropped the "curiae." So when a Justice uses the now-popular phrase "respondents and their amici" he makes no bones about who is friends with whom.[66]

This evolution from friends of the court to friends of the parties need not be a bad thing. As long as the potential biases of the amicus are clear, a Justice can take its arguments and evidence with a grain of salt.[67] This procedure of discounting the value of an argument by the bias of its author is, after all, inherent to the adversarial process.[68] The trouble, of course, is making the biases clear. If a party can hide self-interest behind the ostensible neutrality of a friend of the court, then a Justice will not perform the appropriate discounting. The Court probably had this problem in mind when, well after it lost its innocence about who were its "friends," it amended the amicus curiae rules to require a disclosure statement at the beginning of any amicus brief stating the author's interest and relationship to the parties.[69] Now judges and Justices simply assume that filing an amicus brief is a self-interested act.[70]

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otherwise represented." (citation omitted)). Or, in the words of then-judge Samuel Alito, "an amicus who makes a strong but responsible presentation in support of a party can truly serve as the court's friend." Neonatology Assocs., PA, v. Comm'r, 293 F.3d 128, 131 (3d Cir. 2002).

66. *See, e.g.*, Bilski v. Kappos, 130 S. Ct. 3218, 3248 (2010) (Stevens, J., concurring) ("[P]etitioners and their *amici* . . . ."); McDonald v. City of Chi., 130 S. Ct. 3020, 3047 (2010) ("Municipal respondents and their amici . . . .").

67. This is perhaps the reason why some of the most powerful briefs in antitrust cases are those in which the author advocates a position apparently contradictory to its interests. For example, amici briefs of the United States, though always influential, take on a particular persuasiveness when they support an antitrust defendant in the Supreme Court. "Attention is drawn any time an important antitrust repeat player takes an unpredicted position. No court can lightly dismiss an amicus filing by the Antitrust Division, the FTC, or the states that recommends a resolution against their litigating interests." Calkins, *The Antitrust Conversation*, *supra* note 7, at 628.

68. Rejecting Judge Posner's criticism of partisan amicus briefs, then-Judge Alito wrote that bias among amici comports with "the fundamental assumption of our adversary system that strong (but fair) advocacy on behalf of opposing views promotes sound decision making." *Neonatology Associates*, 293 F.3d at 131.

69. Kearney & Merrill, *supra* note 14, at 766. The Court amended its formal rules on amicus participation in 1997 to require each nongovernment-authored amicus brief to "indicate whether counsel for a party authored the brief in whole or in part and whether such counsel or a party made a monetary contribution intended to fund the preparation or submission of the brief, and [] identify every person other than the *amicus curiae*, its members, or its counsel, who made such monetary contribution." SUP. CT. R. 37.6.

70. *See* Jaffee v. Redmond, 518 U.S. 1, 35–36 (1995) (Scalia, J., dissenting) ("Not a single *amicus* brief was filed in support of petitioner. That is no surprise. There is no self-interested organization out there devoted to pursuit of the truth in the federal courts. The expectation is, however, that *this Court* will have that interest prominently—indeed, primarily—in mind."). This attitude is widespread. *See* Linda Sandstrom Simard, *An Empirical Study of Amici Curiae in Federal Court: A Balance of Access, Efficiency, and Adversarialism*, 27 REV. LITIG. 669, 700, 708–

The authors of notice-and-comment rulemaking probably never went through the naïve stage of believing that third-party comments might come from selfless experts whose only interest was in helping the agency get it "right." In its 1947 *Manual on the Administrative Procedure Act*, the Department of Justice anticipated that comments would come from "interested persons."[71] So as the Court's attitude towards amicus briefs has become more jaded, it has approached the typical agency's view of comments made during informal rulemaking.

In the same way that courts do not decide an antitrust case by tallying up the amici on either side, comment collection during agency rulemaking is not the same as putting the rule to a vote—agencies must respond to material comments, but they need not be swayed by the fact that a majority of interested parties favor one outcome.[72] In this way, both administrative rulemaking and judicial decision making are less political than legislative proceedings, even if we grant that comments and amicus briefs come from politically motivated parties.

B. *Differences—the Court's Hybrid Falls Short of Notice-and-Comment Rulemaking*

The analogy between antitrust adjudication in the Supreme Court and agency rulemaking is imperfect in salient ways. First, amici's arguments are constrained by the existence of named parties to the dispute. Second, the Supreme Court lacks the expertise that would allow an agency to parse theoretical economic arguments and interpret data critically. Third, Justices have no obligation to respond to amicus briefs—indeed they don't even have to read them. Finally, and somewhat ironically, Supreme Court decisions are not subject to judicial review. These differences mean the Court's rulemaking lacks both the informational benefits and the procedural protections of notice-and-comment rulemaking. If we think the APA has improved agency decision making, then we should be worried about ways in which Supreme Court antitrust policy making falls short of the APA's requirements.

1. Fewer Perspectives.—In its simplest form, a legal dispute in our adversarial system is polar: two sides represent opposed interests and each

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09 (2008) (reporting that the majority of surveyed federal court judges and Justices consider an amicus curiae's financial relationship to a litigant when deciding whether to grant leave to file).

71. LAWSON, *supra* note 28, at 240.

72. *See* Grand Canyon Air Tour Coal. v. FAA, 154 F.3d 455, 468 (D.C. Cir. 1998) (affirming that agencies must respond to comments that are "relevant and significant"); Natural Res. Def. Council, Inc. v. EPA, 822 F.2d 104, 122 n.17 (D.C. Cir. 1987) (clarifying that an agency is not obliged to issue rules that comply with the position adopted by the majority of comments).

seeks to win the case. This structure is thought to ensure vigorous representation of the interests at stake.[73] In the traditional domain of the common law, this structure makes sense. Rights relating to property, contract, and tort can be easily conceived of as resolving a struggle between two individuals with conflicting interests. But for creating large-scale public policy—where the interests at stake are myriad, complex, and technical—this dialectic structure of adjudication makes less sense.[74]

Crafting a new antitrust rule is a complex optimization problem in which economic theory and data are used to maximize the undefined "welfare" of a class of people that includes literally everyone: "consumers." But the parties to a Supreme Court antitrust case are usually only two, and often neither can credibly claim to represent the consumer.[75] Naturally, a party only presents economic theory or data if it furthers its own litigation strategy. This leaves a lot of economics out of parties' briefs, either because it is too complicated to be effective in swaying the Justices (as opposed to more familiar modes of argument like parsing precedent or statutes) or because the data or theory support a third position that benefits neither side.

In theory, the use of amici can ameliorate this problem. They can present a third (and fourth and fifth) perspective on the dispute, even suggesting an outcome not advocated by either side. And filing an amicus curiae brief is a way for an expert with all the right information but without the legally protectable interest to present economic evidence. Concern about the lack of consumers' representation and about inadequate efficiency arguments from the parties' briefs probably accounts for some of the Court's attention paid to amicus briefs.[76] And it certainly would explain the attention paid to the Solicitor General, whose briefs have the technical savvy and pro-consumer focus of the Department of Justice Antitrust Division. And since it is the Court's practice to allow all amicus briefing, then the Court could, in theory, get the same variety of perspectives that an agency enjoys during the comment period.

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73. *See, e.g.*, Penson v. Ohio, 488 U.S. 75, 84 (1988) ("The paramount importance of vigorous representation follows from the nature of our adversarial system of justice.").

74. *See* John O. McGinnis & Charles W. Mulaney, *Judging Facts Like Law*, 25 CONST. COMMENT. 69, 109 (2008) ("[T]he judicial process has trouble capturing the multiple perspectives that best map reality, because in some cases there may be more plausible positions than there are litigants.").

75. *Cf.* Richard A. Posner, *The Federal Trade Commission: A Retrospective*, 72 ANTITRUST L.J. 761, 771 (2005) ("The usual complainant about a sales practice is not a consumer, who generally has little to gain from even a successful proceeding, but a competitor of the seller who is employing the practice.").

76. *See* United States v. Barnett, 376 U.S. 681, 738 (1964) ("This court has recognized the power of federal courts to appoint '*amici* to represent the public interest in the administration of justice.'" (quoting Universal Oil Prods. Co. v. Root Ref. Co., 328 U.S. 575, 581 (1946)).

But the number of amicus briefs that the Court receives in a case is typically a fraction of the number of comments an agency receives during a rulemaking.[77] This observation has several possible explanations. First, although it is the Court's practice to give permission to all amicus participation, it is free to deny it. In contrast, an agency engaged in § 553 rulemaking must allow any interested party an opportunity to comment on the agency's proposed rule.[78] If the Court can refuse to accept an amicus brief (and in the early part of the New Deal, it was the Court's practice to *not* accept amicus briefs), some groups may fear being perceived by the Court as unqualified to argue before the court or as representing fringe interests and so will not invest in writing a brief.

Second, amicus argument must conform to the format of a legal brief and any additional requirements Rule 37 imposes.[79] This means that writing an amicus brief without a lawyer is taking an unadvisable risk that your submission will appear amateurish. Legal writing takes time, and a lawyer's time takes money, typically enough to dwarf the fee for filing an amicus brief with the court in the first place.[80] And the brief must be filed according to the Court's byzantine filing procedures.[81] Details matter; even slight deviations from the conventional font, color, or weight of page can mean your brief is not read.[82] In contrast, comments on a proposed rulemaking can take any form and are often made online.[83] Ironically, courts cite the openness of notice-and-comment rulemaking as a reason for greater judicial deference when a rule is challenged in court.[84]

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77. *See* Kearney & Merrill, *supra* note 14, at 754 (discussing the increase in the mean number of amicus briefs per case from about .50 in the late 1940s to 4.23 in the 1990s); Stuart Shapiro, *Presidents and Process: A Comparison of the Regulatory Process under the Clinton and Bush (43) Administrations*, 23 J.L. & POL. 393, 404–05 (2007) (comparing the number of comments federal agencies received on rules under both the Clinton and Bush administrations). For example, in a typical EPA case from the 1980s the agency received 192 comments raising 400 issues. RICHARD J. PIERCE ET AL., ADMINISTRATIVE LAW & PROCESS 329 (5th ed. 2009).

78. 5 U.S.C. § 553(c) (2006).

79. SUP. CT. R. 37.

80. And this cost is incurred even if the Court ultimately denies the party the right to file. "It is awkward, to say the least, to bill a client for a brief the court refuses to accept." Munford, *supra* note 43, at 282.

81. *See* SUP. CT. R. 37 (indicating various requirements for the filing of amicus curiae briefs).

82. *See* SUP. CT. R. 33 (listing specific color, font, and weight requirements for different types of documents submitted to the Court); *see also* Lynch, *supra* note 43, at 44 (reporting clerks' bias against amicus briefs with even minor variations from the Court's paper weight and font requirements).

83. STEVEN P. CROLEY, REGULATION AND PUBLIC INTERESTS 118–19 (2008).

84. *See, e.g.*, Nat'l Petroleum Refiners' Ass'n v. FTC, 482 F.2d 672, 683 (D.C. Cir. 1973) (observing that rulemaking opens up agency policy making to a broader range of criticism and advice than adjudication); *cf. also* CROLEY, *supra* note 83, at 118 ("Formally[] at least, rulemaking is open and inclusive, and parties can participate on their own initiative and directly with the agency.").

Not only are the numbers of participants lower in Supreme Court adjudication than in agency rulemaking, but also the spectrum of ideas and opinions put before the Court is likely to be more limited. Although they are not required to declare their support for one of the parties in the case,[85] most amici filing with the Court, including the Solicitor General, do.[86] This is probably because amicus briefs are often solicited by one side of an antitrust dispute. And, even if a lawyer prepares a brief without prompting from either side, he is trained to see disputes as having two sides.[87] Moreover, from a rhetorical perspective, preserving the appearance of a two-sided debate makes sense, since the record and briefs from the lower court proceedings frame the issues as binary.[88] Justices, themselves lawyers trained in dialectic argument, are likely to consider each argument as cutting one way or another.[89] A good lawyer is loath to be seen by the Court as complicating the issues. So even if amici represent diverse perspectives on a case, all filing parties on a given side have incentives to downplay differences of opinion in order to conform to the adversarial model of litigation.

Amicus briefs sometimes provide good economic arguments, but the Court must take them as it gets them.[90] In contrast, agency rulemaking can involve active investigation into an issue.[91] Comments made during a rulemaking can inform an agency's decision, but the agency is by no means limited to those comments as informational inputs. An agency can solicit

85. *See* SUP. CT. R. 37.2(a) (setting forth the filing requirements for amicus briefs but not explicitly requiring briefs to support one side or the other). In *Leegin*, two economists filing as amici refused to take sides. *See* Brief for William S. Comanor & Frederic M. Scherer as Amici Curiae Supporting Neither Party, Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007) (No. 06-480), 2007 WL 173679; *see also* McGinnis & Mulaney, *supra* note 74, at 109 ("[T]he judiciary permits amicus briefs to represent positions different from those advanced by the plaintiff or defendant.").

86. EUGENE GRESSMAN ET AL., SUPREME COURT PRACTICE 740 (9th ed. 2007).

87. *See* ROBERT A. KAGAN, ADVERSARIAL LEGALISM: THE AMERICAN WAY OF LAW 244 (2003) (observing that American lawyers are trained to argue for their clients rather than for the "best" overall resolution).

88. Professor Horowitz makes the broader point that "*amici* do not have the ability to shape the issues or the factual record . . . *amicus* participation so often begins on appeal, after the record is frozen." DONALD L. HOROWITZ, THE COURTS AND SOCIAL POLICY 44 n.56 (1977).

89. *See* KAGAN, *supra* note 87, at 244.

90. Technically, the Court can request amicus participation, but it usually only uses this power to ask the Solicitor General to file a brief. *See* Garcia, *supra* note 17, at 323 (noting that federal courts have the power to request amicus briefs and that the Supreme Court regularly invites the Solicitor General to submit them).

91. *See* LAWSON, *supra* note 28, at 8–9 (explaining that agencies spend most of their time "analyzing, investigating, synthesizing, deliberating, planning, and studying").

data and opinions through a notice of proposed inquiry.[92] And it can conduct hearings, depose experts, or conduct its own studies on the structure of competition.[93] But the Court lacks these powers and gets only a limited opportunity to ask questions directly of the parties during oral argument. Amici (with the exception of the Solicitor General) cannot participate,[94] so the Court cannot ask clarifying questions about an amicus brief's technical economic arguments.

2. Inexpert Court.—The Supreme Court is comprised of generalist Justices without any particular training in industrial organization.[95] None of the current Justices has an economics degree, even at the undergraduate level. As in all areas of law that require technical savvy, they rely on the parties to present data and theory in easy-to-understand ways, which, even when done well, tend toward oversimplification. On the other hand, antitrust economics may be presented at too high a level, leaving federal judges to despair in their ability to assimilate economic principles into their decisions.[96]

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92. The FCC frequently uses this means of gathering information, a precursor to a proposed rulemaking. *See, e.g.*, 47 U.S.C. § 1302(b) (mandating the Commission to initiate a notice of inquiry concerning the availability of advanced telecommunications capability to all Americans).

93. *See* RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE 946 (5th ed. 2010) (explaining that administrative agencies are not significantly limited in their ability to consider various legislative facts).

94. ROBERT L. STERN ET AL., SUPREME COURT PRACTICE: FOR PRACTICE IN THE SUPREME COURT (8th ed. 2002) (explaining that since 1980 efforts of private amici to participate in arguments have seldom been successful, while the Court is more liberal to the Solicitor General and representatives of states); *see also* FED. R. APP. P. 29 (allowing amici oral argument only with court approval).

95. Although the Court is comprised of generalists and any Justice can write an opinion about anything, often the Justices informally specialize in an area of law, either because of expertise or interest. This is not the case in the last ten years of antitrust jurisprudence. Of the three Justices who have written more than one opinion (majority, concurrence, or dissent) in a substantive antitrust case, no one stands out as having written a particularly large share. Justice Breyer has written three opinions. Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc., 129 S. Ct. 1109, 1123–25 (2008) (Breyer, J., concurring); Credit Suisse Sec. (USA) LLC v. Billing, 551 U.S. 264 (2007); F. Hoffmann-La Roche Ltd. v. Empagran S.A., 542 U.S. 155 (2004). Justice Stevens has written four opinions. Am. Needle, Inc. v. Nat'l Football League, 130 S. Ct. 2201 (2010); *Credit Suisse*, 551 U.S. at 285–87 (Stevens, J., concurring); Ill. Tool Works, Inc. v. Indep. Ink, Inc., 547 U.S. 28 (2006); Volvo Trucks N. Am., Inc. v. Reeder-Simco GMC, Inc., 546 U.S. 164, 182–88 (2006) (Stevens, J., dissenting). And Justice Thomas has written three. *Credit Suisse*, 551 U.S. at 287–90 (Thomas, J., dissenting); Weyerhaeuser Co. v. Ross-Simmons Hardwood Lumber Co., 549 U.S. 312 (2007); Texaco, Inc. v. Dagher, 547 U.S. 1 (2006).

96. *See Findings and Recommendations of the Antitrust Modernization Commission: Hearing Before the H. Comm. on the Judiciary*, 110th Cong. 7 (2007) (testimony of Jonathan R. Yarowsky, Vice Chair, Antitrust Modernization Commission), *available at* http://judiciary.house.gov/hearings/printers/110th/35243.PDF (observing that judges "were particularly daunted by the economics" in antitrust cases).

Agencies, on the other hand, can be staffed by experts with education, research, and experience that help them understand technical arguments affecting policy decisions.[97] Moreover, these qualifications mean that they can actually conduct studies themselves to answer scientific questions relevant to regulation.[98] Independent agencies have perhaps the most potential as scientifically sophisticated decision-making bodies, since they are more shielded from political flux than their executive counterparts.[99] But even executive agencies enjoy insulation from political whim since only the top-level officers rotate with a change in administration. And both executive and independent agencies have access to nonpartisan scientific perspectives through their use of advisory committees.[100] These committees are comprised of working scientists who are not formally employed by the government at all. This is not to say that an agency's scientific perspective is always nonpartisan; gone are the days of lauding agency staff as neutral technocrats without political preferences.[101] But even if those administrators have partisan leanings they also have superior education in and exposure to their field than do judges.

3. No Obligation to Read and Respond.—An agency "must respond in a reasoned manner" to comments made on a proposed rule that "raise significant problems."[102] Although the meaning of "reasoned" and "significant" is the subject of much debate, it is clear that an agency has at least some duty to attend to arguments made during the comment period. Justices are under no such obligation to consider amici's arguments.

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97. For a discussion of the relatively high quality of agency science, see Wendy E. Wagner, *The "Bad Science" Fiction: Reclaiming the Debate Over the Role of Science in Public Health and Environmental Regulation*, 66 LAW & CONTEMP. PROBS. 63, 73–79 (Autumn 2003).

98. For a discussion of how "consensus" of experts should be measured by agencies, see Adrian Vermeule, *The Parliament of the Experts*, 58 DUKE L.J. 2231 (2009).

99. *See* Marshall J. Breger & Gary J. Edles, *Established by Practice: The Theory and Operation of Independent Federal Agencies*, 52 ADMIN. L. REV. 1111, 1114 (2000) (stating that independent agencies are independent of the political will of the Executive Branch). This justification for agency decision making has its roots in the progressive movement and the creation of the FTC, *see id.* at 1131–32 (noting that during the progressive era, expertise and independence were thought to "safeguard the commissions from partisan politics"), but it continues to have traction today. *See* Free Enter. Fund v. Pub. Co. Accounting Oversight Bd., 130 S. Ct. 3138, 3174 (2010) (observing "the constitutional legitimacy of a justification that rests agency independence upon the need for technical expertise").

100. *See* 4 CHARLES H. KOCH, JR., ADMINISTRATIVE LAW AND PRACTICE § 14:53, at 547 (3d ed. 2010) (describing the use of scientific committees which must be fairly balanced and represent divergent interests with regard to the subject matter).

101. For this antiquated view, see works by Joseph Eastman and James Landis excerpted in LAWSON, *supra* note 28, at 25. For the modern understanding that agency decisions are influenced by specific industry interests instead of concern for public wellbeing, see Rachel Barkow, *Insulating Agencies: Avoiding Capture through Institutional Design*, 89 TEXAS L. REV. 15, 21–24 (2010).

102. Reytblatt v. U.S. NRC, 105 F.3d 715, 722 (D.C. Cir. 1997).

Whether and how carefully Justices even read amicus briefs varies greatly by Justice, as does the extent to which clerks are expected to inform a Justice about amicus arguments.[103] Unlike the parties' briefs, at least some amicus briefs probably do not get read at all.[104]

Again, the lack of oral argument hurts third parties' ability to influence the Court. If the Court has not read an amicus brief, then at least oral argument could be an opportunity for its author to present its arguments. But the convention against allowing third parties to participate in oral argument[105] means that unless the parties' advocates choose to bring up the content of an amicus brief, it is a dead letter. And even if the Justices have read an amicus brief, they cannot ask questions about the often highly technical arguments directly to its author. Instead, the parties' lawyers have to become fluent in their amici's science, which is difficult given the time constraints on a noneconomist lawyer preparing for oral argument.

Even though Justices writing antitrust opinions seem to feel some obligation to respond to counterarguments in amicus briefs, they are not strictly obligated to do so. There are no requirements about what a judicial opinion must say, but a statement of basis and purpose must meet certain requirements designed to facilitate judicial review.[106] While a Justice will only address a counterargument from an amicus brief if he feels it rhetorically strengthens the opinion, an agency must thoroughly respond to dissenters. The level of detail required of these ostensibly "concise and general" statements has multiplied with the evolution of the "arbitrary and capricious" to become a "searching and careful" standard.[107] A typical statement of basis and purpose can be as long as 1,600 pages,[108] while the typical Supreme Court opinion is shorter by two orders of magnitude.

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103. *See* Lynch, *supra* note 43, at 43–45 (describing the process by which Supreme Court clerks review amicus briefs).

104. Justice Ginsburg has said "that her clerks often divide the amicus briefs into three piles: those that should be skipped entirely, those that should be skimmed, and those that should be read in full." Simard, *supra* note 70, at 688.

105. *See* FED. R. APP. P. 29 (allowing amici oral argument only with court approval); Abramowicz & Colby, *supra* note 63, at 992 ("[T]hird parties generally cannot participate in oral argument.").

106. *See* Dominique Custos, *The Rulemaking Power of Independent Regulatory Agencies*, 54 AM. J. COMP. L. 615, 625 (2006) ("The exigencies judicially imposed on the writing of the statement of a rule by an American IRA seem to be unparalleled."); Strauss, *supra* note 60, at 757 ("[An] agency would be well advised to write its statement of basis and purpose in a manner clearly demonstrating the factual basis for and reasonableness of its judgments, and that it had taken a 'hard look' at any matters that had proved controversial.").

107. Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402, 416 (1971).

108. PIERCE ET AL., *supra* note 77, at 329; *see also* Strauss, *supra* note 60, at 760.

4. No Judicial Review.—When the Supreme Court makes antitrust policy, its decision is final in a way that an agency's is not. When an agency regulates, the substance of the rule and the procedures for making it can be challenged in a suit. To be sure, agency decisions are not subject to judicial review as a matter of course. Someone with standing must bring suit in court alleging that the rule or the process to create it was illegal. In this sense, judicial review is ad hoc.[109] But even if administrators cannot know for sure that their rule will be challenged, the possibility of a suit likely influences rulemaking. "[A]gency decisionmaking inevitably takes place in the shadow of judicial review."[110]

But nobody has power to review a Supreme Court's decision—at least formally. Informally, Congress can override a bad Supreme Court rule in a nonconstitutional context, such as interpretations of the Sherman Act, by passing a bill that contradicts the decision's effect. In practice, Congress rarely abrogates a Supreme Court Sherman Act decision, either because of the high political costs of doing so or simple inertia.[111]

Apart from concerns about separation of powers, there is a very practical reason why we might want a second pair of eyes on the Court's antitrust decisions. In a typical Supreme Court case, the Justices are at least the second (and usually the third) body to consider the evidence behind a decision. But because of the unusual amount of economic theory and data that is presented for the first time in Supreme Court amicus briefs, the Court is often the first—and the last—body to review it. Often the amici's economics were not presented at trial, where it would have been subject to the rigors of *Daubert*.[112] And often the economic arguments presented to the Supreme Court by amici did not appear even at the court of appeals level.[113]

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109. CROLEY, *supra* note 83, at 99.

110. *Id.*

111. Lance McMillan, *The Proper Role of Courts: The Mistakes of* Leegin, 2008 WIS. L. REV. 405, 457 n.246 ("[L]egislative inertia often makes it difficult to overrule even unpopular decisions."). *But see* 15 U.S.C. § 45(a) (overruling the Supreme Court's decision in Schwegmann Bros. v. Calvert Distillers Corp., 341 U.S. 384 (1951)).

112. Daubert v. Merrell Dow Pharm., 509 U.S. 579 (1993); Garcia, *supra* note 17, at 352–55; *cf.* Simmons, *supra* note 13, at 190 n.12 ("[E]vidence and arguments presented in amicus briefs . . . have not been challenged through the litigation process and are not subject to the same evidentiary safeguards as the parties' briefs.").

113. The D.C. Circuit criticized the Court's willingness to attend to an amicus's Johnny-come-lately arguments, albeit in the administrative law context:

> I recognize that the Supreme Court has moved pretty far from traditional notions of judicial restraint that confine courts to issues presented by the parties, but I think this decision represents another large step in that regrettable process insofar as it was an *amicus*—an *amicus* who had not appeared until the case reached the Supreme Court—who made the dispositive argument, one which was never once made before us.

Akins v. FEC, 146 F.3d 1049, 1050 (D.C. Cir. 1998) (citation omitted).

One might hope the inexpert Court's best understanding of economic theory would get at least a proofread.

Judicial review of agency action can be quite searching and substantive. Courts invalidate rules and decisions because the agency did not consider relevant facts or alternative regulatory outcomes.[114] To a reviewing court, red flags may include an abrupt change in policy in response to political pressure, or asymmetrical attention to various represented interests. Professor Steven Croley argues that these filters serve the commendable purpose of impeding "easy agency delivery of regulatory rents."[115] Besides thwarting rent seeking, judicial review can catch scientific errors.[116]

C. *Relying on Amici Sacrifices the Benefits of the Justiciability Doctrine*

The Court's reliance on amici in antitrust adjudication is a trade-off. On the one hand, it allows the Court to consider more and better economic arguments than it could without amicus participation, even if it falls short of what an agency can do. On the other hand, it may sacrifice some of the epistemological benefits of the legal approach to decision making. The sacrifice is probably worth it; at least one scholar is emphatic that, at least in antitrust cases, the Court is better off with amici than without them.[117] But even if the current hybrid is an improvement upon a pure Article III model of judicial decision making, the hybrid has problems. A complete picture of those problems involves understanding not only how the hybrid falls short of agency decision making but also how it sacrifices the benefits of strict adherence to standing requirements.

Article III of the Constitution confers jurisdiction on federal courts only when they are presented with a live case or controversy.[118] This requirement prevents courts from resolving disputes between nonadverse parties or parties without a tangible stake in the outcome and disputes involving merely speculative injury. In the antitrust context, the Court has further narrowed standing with its notion of "antitrust injury"—a stricter,

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114. CROLEY, *supra* note 83, at 100.

115. *Id.*

116. *See* Wagner, *supra* note 97, at 81 ("Courts . . . provide valuable oversight of the quality of agency science through their review of rulemakings and by ensuring that interested parties have an opportunity to comment on proposed regulations.").

117. *See* Calkins, *The Antitrust Conversation*, *supra* note 7, at 658 ("The antitrust law that we know and apply is almost certainly richer and different because of the active participation of amici.").

118. U.S. CONST. art. III, § 2.

more specific requirement of harm than would satisfy constitutional limitations on standing.[119]

Limitations on justiciability serve both epistemological and political ends. First, they ensure that the legal rule is derived from a complete factual record of actually conflicting interests.[120] With this concrete factual context, a court can see the real-world effects of a statute or a rule and so better determine whether it is legitimate or efficient. Justiciability requirements also promote separation of powers.[121] Without a concrete factual context, the Court would have to engage in speculation about the effect of rules on interested parties, a role that more comfortably suits the politically responsive branches of government.

The requirements of standing—injury, ripeness, and mootness—are, of course, not imposed on amici.[122] A party with an interest in the dispute that falls short of the injury necessary to confer antitrust standing can get the Court's attention by filing an amicus brief. In the context of interpreting the Sherman Act, it makes sense for the Court to broaden the inputs to its decision. The Act delegates authority to make broad economic policy to the Court, and so the Court understandably seeks out the input of those affected by regulation when they regulate. But it is important to consider what is lost when the Court chooses to move away from the adjudicative model.

Without being able to ask of an amicus "what's it to you?,"[123] the Court may not be able to discount amici's economic arguments according to how closely they serve their author's self-interest. It is true that the disclosure statement and the convention of declaring support for one side or the other give the Justices a hint as to a party's interest in a suit. But without a cognizable legal interest at stake, an amicus's bias may not be clear even from these disclosures.

This is especially true in the context of amici such as antitrust and economics professors.[124] The impulse of an academic to file an amicus

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119. Atl. Richfield Co. v. USA Petroleum Co., 495 U.S. 328, 334 (1990). This higher bar for antitrust standing comes from the remedial provision of the Clayton Act. *See* Ill. Brick Co. v. Illinois, 431 U.S. 720, 728–29 (1977) (holding that a pass-on theory could not be used offensively by indirect purchasers).

120. Jonathan R. Siegel, *A Theory of Justiciability*, 86 TEXAS L. REV. 73, 77 (2007).

121. *See, e.g.*, Antonin Scalia, *The Doctrine of Standing as an Essential Element of Separation of Powers*, 17 SUFFOLK U. L. REV. 881, 882 (1983) (arguing that standing doctrine is an "inseparable element" of the principle of separation of powers "whose disregard will inevitably produce—as it has during the past few decades—an overjudicialization of the process of self-governance").

122. 15 JAMES WM. MOORE, MOORE'S FEDERAL PRACTICE § 101.60(12) (Daniel R. Coquillette et al. eds., 3d ed. 2007).

123. Scalia, *supra* note 122, at 882.

124. *See, e.g.*, Brief of Amici Curiae Professors and Scholars in Law and Economics in Support of the Petitioners, Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc., 129 S. Ct. 1109 (2009) (No. 07-

brief with the Court has many potential sources. It might be an opportunity to raise one's scholarly profile or build one's resume for consulting jobs. It could be a political preference, the return of a favor, or an act of collegiality. It might fulfill the professor's desire to see his scholarly position vindicated by a Supreme Court opinion that adopts it. It might even be an altruistic desire for the law to "get it right," as unlikely as this appears to cynics. For the most part, scholars have little to lose by filing an amicus brief, and this should worry the Court about its epistemological value.

Perhaps even more problematic, however, are situations in which the motivations of the amicus are all too clear. Many amici are firms with equivalent financial interests as the party. For example, when the Supreme Court declared that Verizon had no antitrust duty to deal with its competitors,[125] the decision impacted AT&T nearly as much as Verizon, since all incumbent LLCs as the firms had equivalent financial interests. So the two firms (and their successors in interest) took turns as parties and amici in the telecom antitrust cases of the 2000s. Verizon was a party in *Trinko*[126] and *Twombly*[127] and amicus curiae in support of AT&T in *LinkLine*.[128] AT&T was a party in *Twombly* and *Linkline* and amicus curiae in support of Verizon in *Trinko*.[129]

Just because a firm has similar interests as a party and as an amicus does not mean that it presents the same arguments in both roles. Allowing a firm to argue through an amicus brief effectively reduces the cost of litigation for that party, altering its cost–benefit analysis when it decides between aggressive or conservative arguments. An amicus curiae who is not legally bound to pay treble damages to the plaintiff is naturally more inclined to take risks in its argument.[130] Nor is an amicus bound by the judgment under res judicata (absent privity).[131] For example, an amicus might be willing to

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512), 2007 WL 4132899; Brief of Amici Curiae Law Professors in Support of Respondent, Nynex Corp. v. Discon, Inc., 525 U.S. 128 (1998) (No. 96-1570), 1998 WL 331176.

125. Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398 (2004).

126. *Id.*

127. Bell Atl. Corp. v. Twombly, 550 U.S. 544 (2007).

128. Brief for Verizon Communications, Inc. & National Association of Manufacturers as Amici Curiae Supporting Petitioners, *Linkline*, 129 S. Ct. 1109 (No. 07-512), 2008 WL 4154538.

129. Brief of AT&T Corp., Cavalier Telephone, and Competitive Telecommunications Association as Amici Curiae in Support of Respondent, Verizon, 540 U.S. at 398 (No. 02-682), 2003 WL 21767975.

130. Professor Krislov observed that "[a]rguments that might anger the Justices, doctrines that have not yet been found legally acceptable, and emotive presentations that have little legal standing can best be utilized in most instances by the amicus rather than by the principals." Krislov, *supra* note 21, at 712; *see also* Simmons, *supra* note 13, at 228 (discussing the use of risky emotive argumentation in amicus briefs).

131. Lowman, *supra* note 16, at 1260–61.

ask the Court to change the law,[132] but a party, faced with the threat of treble damages, may find that strategy intolerably risky. A party's tactic is likely to be more conservative, arguing for a narrow reading of precedent or for dismissal on a jurisdictional ground.

The Court benefits from amici's risk taking. If the Sherman Act's imperative is to optimize economic efficiency, then the Court should want to encourage arguments about what behavior encourages competition. But usually this kind of argument amounts to a request for a change in law. Lower risk litigation strategies include applying or distinguishing precedent or arguing for a flaw in the Court's jurisdiction. Not surprisingly, the parties emphasize these arguments, sometimes at the expense of more general economic-efficiency arguments. But amici seem more comfortable focusing on economic policy in their briefs, and so the Court benefits from them not being as invested in the outcome as the party. But this very detachment should raise concerns as well. As the Court moves away from a traditionally adjudicative process, it sacrifices something of epistemological value: arguments obtained only from firms forced to put their money where their mouth is.

III. The Court's Recent Mistakes in Antitrust

The Supreme Court's reliance on amicus briefs for economics leads them to make two kinds of mistakes. The first is substantive: because the Justices misunderstand economic theory and data, they sometimes make errors in their economic analysis. The second is procedural: without the right mechanisms for gathering information, the Court sometimes makes decisions without considering all the relevant data.

Two recent Supreme Court cases illustrate these two kinds of errors. In each case, the Court was asked to reconsider long-standing interpretations of the Sherman Act's proscriptions. Each decision required the Court to engage broad questions of economic policy and to estimate the efficiencies of the old rule. In both, the Court depended on amici to guide its theoretical economic analysis and to provide a solid empirical foundation for its decision. In both *Linkline* and *Leegin*, the amici's performance of these tasks left something to be desired.

A. Linkline

In *Linkline*, the Supreme Court all but foreclosed Sherman Act liability for "price squeezes," a basis of liability in *Alcoa*,[133] one of the most famous

132. For example, the amici in *Leegin* openly asked the Court to overrule a century-old precedent. *See infra* subpart III(B).

133. United States v. Aluminum Co. of Am., 148 F.2d 416 (2d Cir. 1945).

American antitrust cases of the twentieth century. A price squeeze occurs when a vertically integrated firm, selling both wholesale inputs for manufacturing a product and the finished product itself, seeks to eliminate a rival who also manufactures the product.[134] If the rival relies on buying inputs from the integrated firm, then the integrated firm can "squeeze" its competitor out of the finished product market by raising the input price it charges the rival and lowering the finished product price it charges to the consumer.[135] The integrated firm adjusts these prices until the rival manufacturer cannot afford to buy the inputs, manufacture the product, and match the integrated firm's low retail price.[136] The rival will (eventually) go out of business, and with the rival manufacturer out of the picture, the integrated firm can raise prices for the finished product and reap monopoly profits.[137]

Linkline, a provider of retail DSL service, alleged that AT&T offered them DSL transmission service (an input for retail DSL) at a price too high to allow Linkline to compete with AT&T's retail DSL prices to consumers.[138] Linkline could not obtain the transmission service from someone else at a lower price because AT&T controls "the 'last mile'—the lines that connect homes and businesses to the telephone network."[139] The Federal Communications Commission, presumably in an effort to subvert AT&T's natural monopoly, required AT&T to "provide wholesale 'DSL transport' service to independent firms" as a condition to a recent merger.[140]

The Supreme Court reasoned that a price squeeze was actually two allegations in one. First, Linkline was arguing that AT&T had an "antitrust duty to deal" with it in the DSL transmission service market, for if AT&T had a right not to deal at all with Linkline, surely Linkline could not complain about the terms of the dealing.[141] Second, the Court said, Linkline accused AT&T of predatory pricing, for the only way low prices to consumers can amount to monopolization under the Sherman Act is in the context of predatory pricing.[142] The Court analyzed these claims one at a

134. 3B PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 141 (3d ed. 2008); Erik N. Hovenkamp & Herbert Hovencamp, *The Viability of Antitrust Price Squeeze Claims*, 51 ARIZ. L. REV. 273, 273 (2009).

135. AREEDA & HOVENKAMP, *supra* note 135, at 141.

136. *Id.*

137. *Id.*; *see* Hovenkamp & Hovenkamp, *supra* note 135, at 274 (describing the traditional model of a "price squeeze" considered by Judge Learned Hand in *Alcoa*, which focused in part on the fact that Alcoa's pricing would drive its manufacturing rivals out of business).

138. Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc., 129 S. Ct. 1109, 1115 (2009).

139. *Id.*

140. *Id.*

141. *Id.* at 1115–16.

142. *Id.* at 1116.

time as "component[s]"[143] of Linkline's claim. As for the allegedly "too-high" wholesale price, the Court's opinion in *Trinko* made clear that an incumbent telecom company, already regulated by the FCC, has no antitrust duty to deal with competitor telecom providers.[144] And, as for the allegedly "too-low" prices that AT&T was charging to its retail DSL customers, because Linkline did not allege the elements necessary to state a predatory pricing claim under *Brooke Group*,[145] there could be no liability for the low retail prices.[146]

The *Linkline* Court's two-component conception of a price squeeze is incoherent. To begin with, the Court was unclear about the relationship between the two components. If a price squeeze plaintiff needs to prove both a duty to deal at the wholesale level and predatory pricing at the retail level, then the Court should have clarified that there is no such thing as a price squeeze under the Sherman Act—that is just what a competitor feels when a monopolizer does two anticompetitive things at the same time.

Instead, the Court articulated its holding thus: "[No] price-squeeze claim may be brought under § 2 of the Sherman Act when the defendant is under no antitrust obligation to sell the inputs to the plaintiff in the first place."[147] So what happens when a defendant *does* have an antitrust duty to deal with the plaintiff, as the court found in *Aspen*,[148] its seminal duty-to-deal case? Although the *Linkline* Court suggested that the answer had to do with below-cost pricing, an economic analysis of the question reveals that the answer should have nothing to do with predatory pricing. The discussion of *Brooke Group* in the context of price squeezes is a non sequitur.[149]

If there is a duty to deal, the integrated firm can squeeze its retail rival without below-cost pricing, but how it does so depends on whether the market for the finished product operates according to Bertrand or Cournot

143. *Id.* at 1119.

144. *Id.*; Verizon Commc'ns Inc. v. Law Offices of Curtis V. Trinko, LLP, 540 U.S. 398, 410 (2004).

145. Brooke Group Ltd. v. Brown & Williamson Tobacco Corp., 509 U.S. 209 (1993).

146. Predatory pricing claims brought under § 2 of the Sherman Act must meet two requirements. First, the plaintiff must prove that its rival's prices are set "below an appropriate measure of its rival's costs." *Id.* at 222. Second, the plaintiff must show that the predator had "a dangerous probability" of recovering the losses incurred from selling at a below-market price. *Id.* at 224. The Court in *Linkline* found that the complaint contained "no allegation that AT&T's conduct met either of the *Brooke Group* requirements." *Linkline*, 129 S. Ct. at 1120.

147. *Linkline*, 129 S. Ct. at 1115.

148. Aspen Skiing Co. v. Aspen Highlands Skiing Corp., 472 U.S. 585 (1985).

149. *See* Sandeep Vaheesan, Pacific Bell v. LinkLine*:* *Price Squeezing and the Limits of Judicial Administrability*, 4 DUKE J. CONST. L. & PUB. POL'Y SIDEBAR 129, 135 (2008) (providing an example of a lower court confusing the similar but distinct concepts of price squeezing and predatory pricing).

competition. If in the hourglass market the firms compete on price (Bertrand), then the integrated firm can squeeze his rival by charging anything above cost for the inputs. To see this, suppose Firm A has a monopoly over the supply of sand, one of the inputs for its other business: manufacturing hourglasses. A's cost of harvesting the sand is $1 per hourglass. It uses some sand to make its own hourglasses (it sells the sand to itself for $1) and sells some sand to a rival hourglass manufacturer, Firm B. If A sells sand to B at the monopoly price, say $3 per hourglass, and if both firms are equally efficient (they have the same average cost of making an hourglass), A will drive B out of business. In Bertrand competition, both firms will drop their price to marginal cost. With a lower cost for the input, A will be able to drop its retail price lower than B can, and B will be squeezed between a high input price and a low retail price and have to exit.

If firms in the hourglass market compete by setting quantity (Cournot), A might have to take an extra step to squeeze B, but still it need not drop its product below any measure of cost.[150] Say that A can price its hourglasses above cost; perhaps the Cournot oligopoly price is $6. Again, the firms are equally efficient at manufacturing hourglasses—it costs them each $2 to make the finished product. The integrated firm makes a profit of $3 on each hourglass it sells (total cost = $1 + $2, revenue = $6). A can charge B the monopoly price for sand ($3) and still not put B out of business because B can turn a profit on its finished hourglasses, although that profit will be smaller than A's ($1 instead of $3).

A will not be happy with the status quo because, with B around, the Cournot oligopoly price is lower and A's market share is smaller. It will want to drive B out by lowering its retail price, temporarily, to $4, which is still above A's cost. Since B's costs are $5 per hourglass, it cannot profitably compete with A's $4 price, and it will go out of business. After B ceases to exist, A can raise its prices again to something more than $6.

A simpler way of saying the above is to say that if a firm has a duty to deal with another firm, it must have a duty to deal on terms that allow the rival to stay in business, or the duty has no meaning at all.[151] So if the Court had found AT&T obligated to deal with Linkline, it would have had

150. A similar result would obtain if above-cost profits in the retail industry existed not because of a Cournot monopoly, but because the products were differentiated. Dennis W. Carlton, *Should "Price Squeeze" Be a Recognized Form of Anticompetitive Conduct?*, 4 J. COMPETITION L. & ECON. 271, 275–76 (2008).

151. *Cf.* Gregory J. Werden, *Remedies for Exclusionary Conduct Should Protect and Preserve the Competitive Process*, 76 ANTITRUST L.J. 65, 76 (2009) (describing the pervasive and continuing duties a court or regulatory agency would have to take on in order to maintain an effective duty to deal that actually preserves competition).

to set the wholesale price of DSL transport service (and perhaps even the retail price of DSL!) such that the gap between wholesale and retail prices covered Linkline's costs. This calculation would have nothing to do with *Brooke Group*'s below-cost pricing or recoupment.[152] Treating a price-squeeze claim as a "step-one, step-two claim," while simple for a judge to understand, misunderstands the economics of squeezes.

The Court's mistake was overzealous analogical reasoning,[153] perhaps a forgivable mistake for Justices who trade in analogy, not economics. For half of the analysis, the analogical technique worked. The Court was quite right to note that if the integrated firm could refuse to deal with its downstream rival altogether, and thus put it out of business, then the downstream rival cannot complain about a squeeze.[154] In this sense, a price-squeeze claim is "like" a duty-to-deal claim.[155] But analogy gets the Court in trouble later, when it reasons that any claim alleging low retail prices as part of an anticompetitive scheme must be "like" predatory pricing and so must meet the requirements of *Brooke Group*.[156] The analogy is tempting—a price squeeze resembles predatory pricing in that the monopolist sacrifices profits temporarily in order to harm a competitor and then recoups those losses (and then some) after the competitor fails and the monopolist can raise prices. But the structure of a squeeze is more complicated, rendering *Brooke Group* inapposite.

The author of the mistaken two-component conception of squeeze claims was Judge Gould, dissenting from the Ninth Circuit opinion below.[157] He suggested that "the notion of a 'price squeeze' is itself in a squeeze between two recent Supreme Court precedents," *Trinko* and *Brooke Group*.[158] This image—snappy and vivid—resonated with the Court because it appealed to analogical and precedential reasoning, the domain of legal thought.

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152. To put the point yet another way: "In adjudicating predatory pricing claims, courts look to whether the *defendant* priced its product below its *own* costs. Courts deciding price squeeze claims, however, consider whether the defendant's pricing conduct reduced or eliminated the *plaintiff*'s profit margins." Vaheesan, *supra* note 150, at 140.

153. For a discussion of the importance of analogy in granting certiorari to antitrust issues, see Hungar & Koopmans, *supra* note 57, at 55 (discussing analogies between *Weyerhaeuser* and *Brooke Group*, *Linkline*, and *Trinko*).

154. Pac. Bell Tel. Co. v. Linkline Commc'ns, Inc., 129 S. Ct. 1109, 1119 (2009); *see* Carlton, *supra* note 151, at 276–77 (explaining the impact of a price squeeze when a duty to deal is, or is not, present).

155. *See Linkline*, 129 S. Ct. at 1119 ("If AT&T had simply stopped providing DSL transport service to the plaintiffs, it would not have run afoul of the Sherman Act.").

156. *Id.* at 1116.

157. Linkline Commc'ns, Inc. v. SBC Cal., Inc., 503 F.3d 876, 885–88 (9th Cir. 2007) (Gould, J., dissenting).

158. *Id.* at 886.

Judge Gould's quip also led to another mistake that only made it harder for the Supreme Court to reject the analogy of squeeze as predatory pricing. Because the plaintiffs believed their claim *could* meet the requirements of *Brooke Group*, they made an unusual tactical decision when AT&T petitioned the Supreme Court for certiorari. Linkline conceded Judge Gould's point, and said it could, in fact, plead its case according to *Brooke Group*'s requirements.[159] Now, Linkline argued, the parties were not adverse, the case was moot, and certiorari was inappropriate.[160] The Court rejected Linkline's claim of mootness,[161] but its attention had been drawn to the idea that *Brooke Group* might apply to squeeze cases, since even the plaintiff concedes so!

Judge Gould's dissent might not have gained traction with the Court were it not for the participation of amicus curiae at the certiorari and merits stages of the Supreme Court case. Judge Gould and Linkline may have initiated the wrong turn in the analysis, but the amici guided the court further down the mistaken path. Amici for AT&T pressed the price-squeeze-as-predatory-pricing analogy in their briefs, even though AT&T itself did not mention it, nor did it argue for *Brooke Group* analysis of squeezes. In both of its amicus briefs, Verizon argued that plaintiffs could not succeed on their squeeze theory without showing below-cost pricing for AT&T's retail DSL service.[162] Likewise, the Washington Legal Foundation and Abbott Laboratories, as amici for AT&T, each pressed the application of *Brooke Group* to the plaintiff's claim.[163] Perhaps most devastatingly, the United States organized its amicus brief in favor of AT&T around the "two component" structure of price squeezes that the Court ultimately adopted in organizing its analysis.[164]

The Court does not directly cite amici for its two-component conception of price squeezes, but there is ample evidence that the Court (or

159. *See* Brief for Respondents at 13, *Linkline*, 129 S. Ct. 1109 (No. 07-512), 2008 WL 4606588 (stating that the price-squeeze claim only survives if it can satisfy the requirements of *Brooke Group*).

160. *See* Brief in Opposition at 2–4, *Linkline*, 129 S. Ct. 1109 (No. 07-512) 2007 WL 4458899 (arguing that a grant of certiorari is inappropriate because the Court has already established controlling precedent and a circuit split does not exist).

161. *Linkline*, 129 S. Ct. at 1117.

162. Brief for Verizon Communications Inc. & National Association of Manufacturers as Amici Curiae Supporting Petitioners, *supra* note 129, at 15–16, 22.

163. Brief for Abbott Laboratories as Amicus Curiae in Support of Petitioners at 9–13, *Linkline*, 129 S. Ct. 1109 (No. 07-512), 2008 WL 4154537; Brief of Washington Legal Foundation as Amicus Curiae in Support of Petitioners at 5, *Linkline*, 129 S. Ct. 1109 (No. 07-512), 2008 WL 4154539 (arguing that plaintiffs must show predatory pricing under the test provided by *Brooke Group*).

164. Brief for United States as Amicus Curiae Supporting Petitioners at 15–18, *Linkline*, 129 S. Ct. 1109 (No. 07-512), 2008 WL 4125498.

its clerks) read the amicus briefs carefully. The opinion's section on mootness responded directly to COMPTEL's amicus brief, quoting from it twice.[165] The Court considered and rejected an alternative to the two-pronged inquiry, the "transfer price test," crediting the American Antitrust Institute's and COMPTEL's amicus briefs for the notion.[166] Likewise, the Court considered and rejected AAI's argument that squeezes "raise entry barriers that fortify the upstream monopolist's position."[167] Additionally, the final opinion bears such striking similarity to the brief for the United States that it is implausible that the Court did not carefully read and consider the Solicitor General's position. And, of all the briefs filed in the case, the Solicitor General's was the most emphatic about the application of *Brooke Group* to price-squeeze claims.

B. Leegin

In *Leegin*,[168] the Court overturned *Dr. Miles*,[169] a century-old case that declared resale price maintenance to be illegal per se under the Sherman Act.[170] Resale price maintenance (RPM) occurs when a wholesaler and a retail distributor agree on the minimum price the retailer will charge for the wholesaler's product.[171] Under the Court's 1911 decision in *Dr. Miles*, RPM was always illegal—if the plaintiff could show such an agreement was in place, he automatically prevailed even if the defendant could offer a pro-competitive justification for the practice.[172]

The precedential erosion of *Dr. Miles* started just eight years later with *Colgate*,[173] in which the Court held that a plaintiff had to show actual agreement between wholesaler and retailer to prevail under *Dr. Miles*.[174] It was not enough to show that the wholesaler announced his wish that the retailer not sell for below a certain price and then unilaterally discontinued sales to retailers who did not oblige.[175] The erosion accelerated in the '70s and '80s

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165. *Linkline*, 129 S. Ct. at 1117. The Court likewise felt obligated to address arguments made by amici that a ruling in favor of AT&T would overrule *Alcoa*. *See id.* at 1120 n.3.

166. *Id.* at 1121–22.

167. *Id.* at 1122.

168. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877 (2007).

169. Dr. Miles Med. Co. v. John D. Park & Sons Co., 220 U.S. 373 (1911).

170. *Id.* at 409.

171. OZ SHY, INDUSTRIAL ORGANIZATION: THEORY AND APPLICATIONS 383 (1995).

172. *See Leegin*, 551 U.S. at 881 ("In *Dr. Miles* . . . the Court established the rule that it is *per se* illegal under § 1 of the Sherman Act . . . to set a minimum price the distributor can charge for the manufacturer's goods.").

173. United States v. Colgate & Co., 250 U.S. 300 (1919).

174. *See id.* at 307–08 (distinguishing *Colgate* from *Dr. Miles* by noting that in *Colgate* there was no evidence of an agreement to control prices).

175. *See id.* at 307.

as legal scholars began to articulate pro-competitive justifications for vertical restraints like RPM.[176] And, in *GTE Sylvania*,[177] the Court removed the per se illegal status for nonprice vertical restraints, such as territories.[178]

Dr. Miles was sick, but not dead, when Kay's Kloset sued Leegin in 2003. Kay's, a retail distributor of Leegin's line of accessories marketed under the brand "Brighton," claimed that Leegin conditioned the store's status as a Brighton retailer on Kay's promise not to cut prices.[179] Leegin had been more overt about its RPM policy than most firms who wanted the benefits of RPM but feared liability under *Dr. Miles*. Most firms sought the safe harbor of *Colgate* by only acting unilaterally, staying on the right side of the line between using termination threats to induce minimum pricing rather than making actual agreements with retailers.[180] Leegin's policy crossed that line flagrantly and in writing; they required stores carrying Brighton products to sign an agreement preventing markdowns.[181] The suit should have been a slam dunk for Kay's, but the recent ill-health of *Dr. Miles* emboldened Leegin to take it to trial and even to introduce economic expert testimony to the effect that the per se prohibition on RPM, the governing Supreme Court rule for almost a century, was economically wrong headed.[182] Of course, the district court excluded the testimony, found in favor of Kay's, and entered judgment against Leegin.[183]

After the Fifth Circuit affirmed,[184] the controversy reached its intended audience: the Supreme Court, the only court that could actually overrule

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176. *See, e.g.*, ROBERT H. BORK, THE ANTITRUST PARADOX 280–98 (The Free Press 1993) (1978) (arguing that the law prohibiting RPM is "at war with sound antitrust policy" because manufacturers impose RPM not to restrict output and eliminate rivalry but to create distributive efficiency); Richard A. Posner, *Antitrust Policy and the Supreme Court: An Analysis of the Restricted Distribution, Horizontal Merger and Potential Competition Decisions*, 75 COLUM. L. REV. 282, 283–85 (1975) (explaining that manufacturers may set retail price minimums to encourage dealers to increase point-of-sale services for the product, thus improving the marketing for the manufacturer's product).

177. Cont'l T.V., Inc. v. GTE Sylvania Inc., 433 U.S. 36 (1977).

178. Many commentators have noted the incoherency of treating non-price and price-based vertical restraints differently. *E.g.*, Richard A. Posner, *The Next Step in the Antitrust Treatment of Restricted Distribution: Per Se Legality*, 48 U. CHI. L. REV. 6, 8–14 (1981).

179. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 883–84 (2007).

180. Christopher R. Leslie, *Unilaterally-Imposed Tying Arrangements and Antitrust's Concerted Action Requirement*, 60 OHIO ST. L.J. 1773, 1797–98 (1999). For a discussion of the inefficiencies of *Colgate*'s formalism, see Howard P. Marvel, *The Resale Price Maintenance Controversy: Beyond the Conventional Wisdom*, 63 ANTITRUST L.J. 59, 91 n.76 (1994).

181. *Leegin*, 551 U.S. at 883.

182. Deposition of Kenneth G. Elzinga, Ph.D., Ex. A to Leegin's Response to Plaintiff's Motion to Limit Testimony of Kenneth G. Elzinga, Ph.D., PSKS, Inc. v. Leegin Creative Leather Prods., Inc., No. 2:03-CV-107, 2003 WL 24080773 (E.D. Tex. March 18, 2003).

183. *Leegin*, No. 2:03-CV-107, 2004 WL 5374523, at *5 (E.D. Tex. March 26, 2004).

184. PSKS, Inc. v. Leegin Creative Leather Prods., Inc., 171 Fed. App'x. 464 (5th Cir. 2006), *rev'd and remanded*, 551 U.S. 877 (2007).

Dr. Miles. Leegin was not coy about its intentions, arguing from the certiorari stage that the Court must overrule *Dr. Miles* if it hoped to maintain an economically coherent jurisprudence on vertical restraints.[185] Justice Kennedy, writing for the majority, did just that in a lengthy opinion that analyzed the economic arguments on both sides of the RPM debate, as well as more judgly considerations like stare decisis and the relative value of clear rules and fuzzy standards.[186] Justice Kennedy concluded that since economic theory raised several legitimate procompetitive justifications for RPM, the practice would not "always or almost always tend to restrict competition and decrease output" and so a per se ban was inappropriate.[187]

Economists defend RPM by arguing that the practice can encourage competition along nonprice dimensions.[188] Without RPM, a retailer can always price compete with other retailers. He may find that he maximizes profit by investing in an elegant store and quality salespeople because he can sell belts and handbags for a price that more than makes up for these investments. Or he may find that a bin of discounted belts and handbags in a basement store attracts so many price-conscious customers that the sheer number of products he sells makes up for the low price he gets for each individual sale. But the retailer considering the high-end option encounters a problem in the form of free riding.[189] If his bargain-basement competitors offer the same product for less, then shoppers may start at his elegant store, benefit from the help of his knowledgeable staff, and then go to the bargain-basement to actually buy the product.[190] With free riding, shop owners have a reduced incentive to invest in service and presentation.

A manufacturer or wholesaler might want its brand to be associated with elegance, service, and status. But unless he can contract with each retailer for specific levels of service and display[191] (and monitor their performance!) he may be powerless to influence the retailer's choices, and this is especially troublesome if the free rider problem drives service and ambiance down anyway. But if he eliminates a retailer's ability to drop the price, then the retailer's only opportunity to compete with other retailers is

185. Petition for Writ of Certiorari at *5–7, *Leegin*, 551 U.S. 877 (No. 06-480), 2006 WL 2849384.

186. *Leegin*, 551 U.S. at 881–908.

187. *Id.* at 886 (quoting Business Elecs. Corp. v. Sharp Elecs. Corp., 485 U.S. 717, 723 (1988)).

188. One of the earliest proponents of this perspective was Professor Lester G. Telser. *See* Lester G. Tesler, *Why Should Manufacturers Want Fair Trade?*, 3 J.L. & ECON. 86 (1960).

189. BORK, *supra* note 177, at 290.

190. *Id.*; *see also* 8 PHILLIP E. AREEDA & HERBERT HOVENKAMP, ANTITRUST LAW 13–14 (2d ed. 2004).

191. *Cf.* Tesler, *supra* note 189, at 94 ("[A manufacturer] may refuse to sell his product to any retailer who does not provide the requisite special services.").

to offer better service and presentation.[192] In effect, RPM gives manufacturers control over the image of their products and the level of point-of-sale services available to their customers by getting rid of the free rider problem.[193] This stimulates interbrand competition, even if it reduces intrabrand competition.[194]

Even the proponents of RPM acknowledge that it has its anticompetitive uses. It has the effect, always suspect under the Sherman Act, of raising the price of a given product.[195] RPM defenders counter that the product itself is different under an RPM scheme because it includes the prestige, experience, and service that would otherwise not have come without RPM.[196] Some economists counter that there is no reason to believe that consumers value these extra services. Professors (and *Leegin* amici) Scherer and Comanor argue that "RPM, as a result, need not enhance consumer welfare even when it is in the manufacturer's interest."[197]

Perhaps most troubling is the possibility that RPM can be used to foster price fixing cartels, which are uncontroversially illegal per se under the Sherman Act.[198] If instead of nakedly colluding, a group of competing retailers could coerce their wholesaler into enforcing resale price agreements with them,[199] then they would get all the benefits of price fixing

192. *See* Posner, *supra* note 179, at 11 ("[T]he manufacturer's objective in restricting competition among its dealers or distributors is to induce them to provide greater services to the consumer.").

193. *See* Easterbrook, *supra* note 3, at 148 (explaining how "full service" stores that provide better point-of-sale services like information and support can be undermined by "low service" stores that provide no point-of-sale services when customers visit the full service store to obtain information but ultimately order the product from a low service store).

194. *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 913 (2007) (Breyer, J., dissenting) ("The result [of RPM] might be increased competition at the producer level, *i.e.*, greater *inter*-brand competition . . . .").

195. *Leegin*, 551 U.S. at 912 (Breyer, J., dissenting) (citing 8 AREEDA & HOVENKAMP, *supra* note 191, at 40).

196. *See* 8 AREEDA & HOVENKAMP, *supra* note 191, at 12 (discussing how service and presentation can enhance brand image); Posner, *supra* note 179, at 19 (questioning the superiority of lower prices to better services). For an example of how provision of sales service can create product value, see Marvel, *supra* note 181, at 63 ("When first introduced, food processors did not have an obvious use. To be marketed effectively, consumers had to be shown the capabilities of food processors, a requirement met through expensive and detailed dealer-provided demonstrations.").

197. Marvel, *supra* note 181, at 67 (citing works by Professors Comanor and Scherer).

198. 8 AREEDA & HOVENKAMP, *supra* note 191, at 42.

199. *See* Pauline M. Ippolito & Thomas R. Overstreet, Jr., *Resale Price Maintenance: An Economic Assessment of the Federal Trade Commission's Case Against the Corning Glass Works*, 39 J.L. & ECON. 285, 298 (1996) ("Under this theory, [the manufacturer] would have been induced to use RPM by its dealers, through credible threats of a group boycott of [the manufacturer's] products.").

without the § 1 liability.[200] In addition to facilitating retail cartels, RPM might help manufacturers police their own illegal arrangements.[201] A member of a manufacturer cartel may be tempted to cheat by lowering his wholesale price to a retailer, but if that retailer cannot pass that lower price on to his customers, then total demand for the product will not change.[202] The cheating wholesaler will only benefit, then, to the extent that some retailers stop buying from his coconspirators to buy from him.[203] If the coconspirators' sales go down while the cheater's go up, coconspirators will know he is cheating.[204]

At bottom, *Leegin* was a case about rules versus standards. The question was not whether RPM should be legal or illegal but rather what kind of rule should apply to it: the bright line of per se or the flexibility of rule of reason analysis. The bright line invalidated the procompetitive uses of RPM, while the rule of reason would be clumsy and, in practice, would mean the defendant always wins.[205] Appropriately, the *Leegin* opinion was framed around this question of what kind of rule is appropriate for a practice that has some good and some bad uses.[206] But the Court failed to recognize that in order to answer this question, it needed to know something about the relative frequency of the good and bad uses.

The Court reasoned that if a practice has any theoretical benefits, then it cannot be properly subject to a per se rule,[207] but the question was properly empirical, not theoretical. The Court was bombarded with theoretical arguments in favor of RPM from amici, but none could identify, as a practical matter, how often the practice was used for competitive good

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200. *See* Easterbrook, *supra* note 3, at 141–43; Edward O. Correia, *Resale Price Maintenance—Searching for a Policy*, 18 J. LEGIS. 187, 230 (1992).

201. 8 AREEDA & HOVENKAMP, *supra* note 191, at 88; Correia, *supra* note 201, at 221–24. For example, the federal government's 1926 case against General Electric involved resale price maintenance of light bulbs that was used to police a manufacturer-level cartel. Tesler, supra note 189, at 101.

202. 8 AREEDA & HOVENKAMP, *supra* note 191, at 87.

203. *Id.*

204. *Id.* at 88–91.

205. *See* Robert Pitofsky, *In Defense of Discounters: The No-Frills Case for a* Per Se *Rule Against Vertical Price Fixing*, 71 GEO. L.J. 1487, 1489–90 (1983) ("It is instructive that in the almost three years since the Department of Justice and the Federal Trade Commission took the enforcement position that vertical minimum price fixing is illegal only if unreasonable under a rule of reason, neither agency has found a single instance of vertical price fixing worthy of challenge.").

206. *See* Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 889 (2007) (noting the existence of authority supporting both procompetitive and anticompetitive effects of RPM).

207. *See id.* at 886 ("[W]e have expressed reluctance to adopt *per se* rules . . . where the economic impact of certain practices is not immediately obvious." (quoting State Oil Co. v. Khan, 522 U.S. 3, 10 (1997))).

instead of competitive evil.[208] The easier and more intuitively appealing way for the Court to approach the question, then, was to decide the case on purely theoretical grounds: if amici could produce enough hypothetical benefits of RPM, that would cast doubt on the proposition that RPM "always or almost always tend[ed] to restrict competition and decrease output," making a per se rule inappropriate. Because "[v]ertical agreements establishing minimum resale prices can have either procompetitive or anti-competitive effects, depending on the circumstances in which they are formed,"[209] a per se rule lacked the nuance necessary to sort out the good eggs from the bad ones.

But the question of which kind of rule is most efficient—bright line or standard—cannot be satisfactorily answered without data on the costs and benefits of each option. A good decision, therefore, depends not only on the frequency of anticompetitive uses of RPM but the magnitude of the competitive harm, as weighed against the frequency and magnitude of the competitive benefit. Indeed, this was the basis for Justice Breyer's dissent.[210] The Court was woefully lacking in this information, and it had no investigatory abilities to gather it itself. So the case was decided a little on anecdote and mostly on theory. With the economic information before them, mostly from amici, the Court arguably made the best decision it could, but that is only slight praise when one sees the thinness of the data provided by amici.

The Court placed great weight on two amicus briefs[211] (certiorari[212] and merits) signed by twenty-five economists supporting rule of reason for RPM liability, citing them directly four times in the opinion (the dissent cited them once).[213] The economists' briefs articulated the procompetitive justifications for RPM, with an especially lucid passage on the free-rider

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208. Part of the problem, of course, is that RPM was per se illegal for a century, so it would naturally be difficult to extrapolate its use from past experience. But unilateral RPM, legal under *Colgate*, was frequently used and had some of the same procompetitive and anticompetitive aspects as RPM by agreement. Analogy, then, was possible, if imperfect.

209. *Leegin*, 551 U.S. at 894.

210. *Id.* at 909–18 (Breyer, J., dissenting).

211. Motion for Leave to File Brief and Brief of Amici Curiae Economists in Support of Petitioner, *Leegin*, 551 U.S. 877 (No. 06-480), 2006 WL 3244034; Brief of Amici Curiae Economists in Support of Petitioner, *Leegin*, 551 U.S. 877 (No. 06-480), 2007 WL 173681.

212. In an unusual move, Kay's denied consent to all amicus participation in favor of certiorari, forcing amici to appeal to the Court for leave to file. *See* Motion for Leave to File Brief and Brief of Amici Curiae Economists in Support of Petitioner, *supra* note 212 ("Petitioner has consented to the filing of this brief, but Respondent has withheld consent, thus necessitating the filing of this motion."). As discussed, the Court's practice is to give its permission as a matter of course, *see supra* subpart I(A), and it did. Kay's did not bother to oppose the amicus participation at the merits stage of briefing.

213. *Leegin*, 551 U.S. at 889, 900, 904, 914.

problem.[214] They explained why RPM is a more efficient means of ensuring point-of-sale perks than contracts between the manufacturer and retailer about the appearance and experience of buying a product.[215] But the brief was also up-front about the possible anticompetitive uses of RPM, identifying how the practice can be used to facilitate cartels at both the retail and wholesale levels.[216] After surveying the theoretical uses of RPM, the economists concluded with a syllogism that the Court ultimately adopted: if per se liability is only for practices that are almost always harmful, and RPM is sometimes harmful and sometimes beneficial, then the right rule cannot be per se condemnation.[217]

Although Professors Comanor and Scherer signed the economists' brief, it turns out they did not endorse this syllogism. Leegin cited Comanor's and Scherer's economic scholarship as supporting rule of reason analysis for RPM.[218] But their scholarship explaining procompetitive uses for RPM was purely theoretical. Since the relative efficiency of rule of reason analysis depended on how often the practice would be used in the theoretically beneficial way, about which they had no data, they were agnostic about the choice.[219] Miffed at being co-opted to the rule of reason side, they filed an amicus brief after the twenty-five economists' "in support of neither party."[220] In it they explained their academic work and said that they only signed the economists' amicus brief on the condition that it say "there is disagreement among economists about the prevalence of pro- and anti-competitive uses of RPM."[221]

The Court was presented with some empirical information about the benefits and costs of the *Dr. Miles* rule, but it was thin and unconvincing.[222] Several amici cited an article with a promising title: "Resale Price

214. Brief of Amici Curiae Economists In Support of Petitioner, *supra* note 212, at 5–9.

215. *Id.* at 9.

216. *Id.* at 13.

217. *See id.* at 16 ("The position absent from the literature is that minimum RPM is most often, much less invariably anticompetitive. Thus, the economics literature provides no support for the application of a *per se* rule.").

218. Reply Brief for Petitioner at 7 n.3, *Leegin*, 551 U.S. 877 (No. 06-480), 2007 WL 835316.

219. Brief for William S. Comanor and Frederic M. Scherer as Amici Curiae Supporting Neither Party at 4–7, *Leegin*, 551 U.S. 877 (No. 06-480), 2007 WL 173679.

220. *Id.*

221. *Id.* at 3.

222. Perhaps even more problematic was the empirical evidence that was available but that was *not* presented to the Court by amici or anyone else. For example, Professors Ippolito and Overstreet have empirically examined how a judgment ending Corningware's decades-long use of RPM affected the market for glass cookware and serving ware. In the case study, the professors measured the competitive value of RPM by asking if its discontinuation made the relevant market more or less competitive. Ippolito & Overstreet, *supra* note 200, at 293–94.

Maintenance: Empirical Evidence from Litigation" by Pauline Ippolito[223] of the Federal Trade Commission (FTC). Her study was cited by multiple amici (the economists, CTIA, the United States, and the American Petroleum Institute)[224] for the proposition that, as an empirical matter, RPM is rarely used to facilitate cartels. But, as the dissent points out, the study's methodology cannot support this conclusion.[225] Ippolito found that among the 153 RPM cases filed in federal court from 1976 to 1982, only 5.9% alleged a manufacturer cartel.[226] She concluded that "there is little evidence . . . to support the hypothesis that the RPM law primarily deters collusion or that collusion is the primary reason for the use of RPM."[227] But counting allegations of collusion in RPM cases is a faulty way to measure the frequency with which manufacturers use RPM to collude, because if a plaintiff has evidence of RPM, an allegation of horizontal collusion is redundant.

Another promising title, "Resale Price Maintenance: Economic Theories and Empirical Evidence,"[228] provided a slightly more robust empirical payoff. Thomas Overstreet showed that during the reign of the Miller–Tydings Act,[229] which allowed states to pass laws allowing RPM, the states that chose to allow RPM had higher average consumer prices (by as much as 27%) than the fourteen states that did not.[230] Justice Breyer, in his *Leegin* dissent, multiplied this fraction by the amount the average family spends today on goods likely to be subject to RPM, to forecast "retail bills that are higher by an average of roughly $750 to $1,000 annually for an American family of four."[231]

Amici also presented empirical evidence by anecdote, most saliently by PING, Inc., a manufacturer of high-end golf equipment who filed an

223. Pauline M. Ippolito, *Resale Price Maintenance: Empirical Evidence from Litigation*, 34 J.L. & ECON. 263 (1991).

224. Brief of the American Petroleum Institute as Amicus Curiae Supporting Petitioner at 11 n.3, *Leegin*, 551 U.S. 877 (No. 06-280), 2007 WL 160781; Brief of CTIA—The Wireless Association as Amicus Curiae in Support of Petitioner at 14–15, *Leegin*, 551 U.S. 877 (No. 06-280), 2007 WL 160782; Brief of Amici Curiae Economists In Support of Petitioner, *supra* note 212, at 14–15; Brief for the United States as Amicus Curiae Supporting Petitioner at 20, *Leegin*, 551 U.S. 877 (No. 06-280), 2007 WL 173650.

225. *Leegin*, 551 U.S. at 920 (Breyer, J., dissenting).

226. Ippolito, *supra* note 224, at 282 tbl.7.

227. *Id.* at 281.

228. THOMAS R. OVERSTREET, JR., BUREAU OF ECONOMICS STAFF REPORT TO THE FTC—RESALE PRICE MAINTENANCE: ECONOMIC THEORIES AND EMPIRICAL EVIDENCE (1983), *available at* http://www.ftc.gov/be/ecourpt/233105.pdf.

229. Miller–Tydings Fair Trade Act, ch. 690, 50 Stat. 693 (1937) (repealed 1975).

230. OVERSTREET, *supra* note 229, at 112.

231. Leegin Creative Leather Prods., Inc. v. PSKS, Inc., 551 U.S. 877, 926 (2007) (Breyer, J., dissenting).

amicus brief supporting Leegin.[232] In its brief, PING emphasized the costs of the current per se rule, claiming to have spent millions in legal fees on maintaining a unilateral price maintenance scheme that would pass *Colgate* muster.[233] They highlighted the absurdity of having to tell their retailers that PING and the retailers cannot agree on a resale price, but if they sell golf clubs to customers for less than a given price, then they will be terminated.[234] PING also pointed out the inefficiencies of having to divert all inquiries about resale pricing to their legal department.[235] The National Association of Manufacturers, in its brief, made a similar point, slamming the inefficiencies of the *Dr. Miles–Colgate* line.[236]

What was the Court to do with scant, old, and anecdotal evidence of the per se rule's efficiencies? The answer, according to a dissenting Justice Breyer, was to leave standing precedent in place; in the face of indeterminacy, the law prefers the status quo.[237] But the majority opinion had an equally appealing logic: in the face of indeterminacy, the law prefers a flexible standard that allows for individualized inquiry.[238] Without rigorous data about the costs and benefits of RPM, neither position is epistemologically justifiable. The majority–dissent debate devolved into a discussion of whether a tie ought to go to the runner or the baseman, in this case to the plaintiff or the defendant. But what we have in the RPM debate is not a tie—it is an uncertainty. It is not that the benefits of RPM are close to its costs, but that the relative costs and benefits of RPM are *unknown*. The amici could only provide theory and anecdote, and without the ability to empirically investigate RPM itself, the Court ultimately divided according to political preferences about regulation.[239]

IV. A New Deal for Antitrust

Without the informational benefits of expertise and notice-and-comment rulemaking, the Court may be a poor choice to define the broad proscriptions of the Sherman Act. Framed this way, the problem has an

232. Brief of PING, Inc. as Amicus Curiae in Support of Petitioner, *Leegin*, 551 U.S. 877 (No. 06-480), 2007 WL 173680.

233. *Id.* at 10.

234. *Id.* at 15.

235. *Id.* at 11–15.

236. Motion for Leave to File Brief Amicus Curiae and Brief Amicus Curiae of the National Association of Manufacturers in Support of Petitioner at 6–11, *Leegin*, 551 U.S. 877 (No. 06-480), 2006 WL 3244035.

237. *Leegin*, 551 U.S. at 929 (Breyer, J., dissenting).

238. *See id.* at 894 (arguing that because RPM's anticompetitive effects are uncertain, "these agreements appear ill suited for *per se* condemnation").

239. Only the liberal Justices dissented: Justices Breyer, Stevens, Souter, and Ginsburg.

obvious solution: give the power to interpret the Act to an expert agency.[240] This idea has academic support already,[241] and the case for it is strengthened by this Article's observation that the Court has tried to approximate administrative decision making by relying on amicus briefs. The obvious candidates for reallocation are the two existing antitrust agencies: the Department of Justice's Antitrust Division and the FTC.

A. The Agency Solution

Using agencies to give specific meaning to American antitrust's most important statute means avoiding the problems with the Court's current quasi-administrative process for rulemaking. As adjudicators, agency experts would know what kind of economic evidence is necessary for an efficient solution and would be better able to understand it when it is presented by the parties. Repeat exposure to antitrust cases would only reinforce this advantage, while also giving the administrative judges a broader perspective on what kinds of conflicts commonly arise in competition law, a perspective necessary for efficient policy making in the first instance. A Supreme Court Justice hears about one antitrust case a year, hardly the cross section of controversies necessary to make efficient economic policy writ large.

Agencies could take policy making a step further using notice-and-comment rulemaking. Unlike in adjudication, regulation by rulemaking can be initiated without the formal requirements of a case or controversy and a proper appeal to the Supreme Court. Informal letters of complaint could spark an investigation. A rule-making agency could announce its intention to regulate publicly and provide a convenient venue for, or even solicit, expert opinions on the economic impact of the proposed rule. Not only would it have the benefit of these numerous perspectives, but it would also have the obligation to respond to them in a reasoned manner. Its rule would be subject to judicial review, affording an opportunity to catch mistakes[242] or invalidate rules that do nothing but deliver rents to special interests.

Another advantage of rulemaking, an option for agencies but not for the Court, since it only operates through adjudication, is that rulemaking

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240. I am indebted to Harvard Law School Climenko Fellow Michael Burstein for helping me develop this idea.

241. *E.g.*, Crane, *supra* note 5, at 1211.

242. In contrast, when a court makes an antitrust rule in the first instance, its mistakes may go unchecked. *See, e.g.*, C. Scott Hemphill, *An Aggregate Approach to Antitrust: Using New Data and Rulemaking to Preserve Drug Competition*, 109 COLUM. L. REV. 629, 674 (2009) ("The Court relied, as a reason to deny antitrust liability, upon the mistaken idea that a settlement with one generic firm would spur other generic firms to action, and that these firms would have the large incentive provided by the exclusivity period. In fact, later filers are ineligible for the exclusivity period.").

regulates behavior ex ante, while resolution of economic policy through cases is necessarily ex post. Antitrust courts worry obsessively about "chill"—deterring procompetitive behavior with overly broad rules for liability.[243] In fact, the overruling of *Dr. Miles* in *Leegin* implies that the entire twentieth century was a period of inefficient business practices and stunted innovation in distribution because of an early misunderstanding of RPM. Only after a long and expensive period of litigation was Leegin redeemed for breaking the law by effecting a change in the law, and only after *Leegin* was issued were similar firms, perhaps walking the *Colgate* line better than Leegin, redeemed for wanting some control over their product's ultimate retail price.[244] The problem of ex post rulemaking is made worse by the treble damages afforded successful plaintiffs suing under the Sherman Act.[245] To create a new form of liability, the Court has to punish a firm threefold for complying with standing antitrust norms. Thus Supreme Court lawmaking in antitrust is a kind of one-way ratchet.[246]

The result of the current ex post scheme is that "antitrust law leaves considerable gaps between what is permissible and what is optimal."[247] With judges making the rules one case at a time, this gap is justifiable. As discussed above, when judges are not economically sophisticated enough to know where "optimal" lies,[248] laissez-faire is a very inexpensive regulatory regime for courts to follow, and raising the level of regulation would effect a kind of taking of property from firms operating under the status quo. So if the Court is making antitrust policy, laissez-faire may be the only sensible approach. But that is not to say that it is the *most* sensible approach. An agency could provide firms with the necessary clarity—ex ante—that they

243. *See, e.g.*, Barry Wright Corp. v. ITT Grinnell Corp., 724 F.2d 227, 234 (1st Cir. 1983) (Breyer, J.) ("Rules that seek to embody every economic complexity and qualification may well, through the vagaries of administration, prove counter-productive, undercutting the very economic ends they seek to serve."). Professors Hungar and Koopmans argue that Circuit cases that punish procompetitive behavior are especially likely to be reviewed by the Court. Similarly, the Court worries about the "chilling effect of vague rules." Hungar & Koopmans, *supra* note 57, at 56; *cf.* Posner, *supra* note 179, at 15 (arguing that the vagueness of the Rule of Reason "places at considerable hazard any restriction that a manufacturer imposes on its dealers and distributors").

244. And RPM is hardly the only example of conduct, once prohibited by antitrust, that has been made legal by the Court citing pro-competitive grounds. "Despite the fact that the Sherman Act's text has remained unchanged the Court has pulled sudden 'switcheroos' on its rules for monopolization, mergers, and vertical integration." Andrew S. Oldham, *Sherman's March (In)to the Sea*, 74 TENN. L. REV. 319, 366–67 (2007) (citation omitted).

245. 15 U.S.C. § 15(a) (2006).

246. *Contra* Easterbrook, *supra* note 3, at 139 ("[T]here is no ratchet in antitrust. . . . The belated arrival of wisdom is no reason for refusal to learn and change.").

247. Crane, *supra* note 5, at 1193.

248. *See* United States v. Topco Assocs., 405 U.S. 596, 609 (1972) ("The fact is that courts are of limited utility in examining difficult economic problems."); *see also id.* at 611 (Blackmun, J., concurring) ("[C]ourts are ill-equipped and ill-situated for" antitrust policy making).

need when conducting business in a world where competitive behavior so closely resembles anticompetitive conduct. The current state of affairs is that much more is illegal on the books than antitrust lawyers think is actually likely to be struck down in a court.[249] Lawyers thrive in such a legally uncertain world, but firm efficiency suffers.

To inform its rulemaking and adjudicative decisions, an expert agency would have investigative abilities the Court lacks. It could gather data and conduct studies when good antitrust policy depends on hard facts, which, so the consensus holds, it usually does.[250] Data collection would be much easier for an agency than for the Court, since an agency can be endowed with broad investigatory powers and some, unlike the Supreme Court, can demand discovery and "require firms to supply annual and special reports."[251] An agency might employ hundreds of economists and statisticians well-qualified to design such a study and analyze its results. Defendants would no longer be able to advocate against liability by saying that the theoretically efficient rule is so unwieldy in the hands of inexpert judges that laissez-faire is the only workable option. To be sure, they could still argue that the theoretically efficient rule is too indeterminate even for economists to pinpoint, or too abstract to be clearly articulated to regulated firms. But if we think economists have at least a marginally higher tolerance for economic complexity than do lay judges, the economists must be better at fashioning and enforcing rules that regulate sensitive real-world economic systems.

B. The Antitrust Division or the FTC?

Under the current regime, the FTC and the Antitrust Division share the responsibility of promulgating and enforcing antitrust rules,[252] but neither is authorized to interpret the Sherman Act in the first instance. The Antitrust Division's primary areas of activity are criminal cartel prosecution and merger law enforcement.[253] The Antitrust Division does not issue rules subject to *Chevron* deference, but it does issue guidelines that are influential on courts and so also on firm behavior. The most well-known of these guidelines are the *Horizontal Merger Guidelines* that the FTC uses to

249. *See, e.g.*, DOUGLAS BRODER, U.S. ANTITRUST LAW AND ENFORCEMENT 11–12 (2010) (characterizing the George W. Bush Administration's approach to antitrust as a return to "the free-market, anti-enforcement policies of the Reagan and first Bush [A]dministrations").

250. *See generally* 15 U.S.C. § 46 (2006) (describing the investigatory and reporting capabilities of the FTC).

251. MARK R. JOELSON, AN INTERNATIONAL ANTITRUST PRIMER 35 (3d ed. 2006).

252. ANTITRUST MODERNIZATION COMMISSION, REPORT AND RECOMMENDATIONS 13–14 (2007).

253. JOELSON, *supra* note 252, at 31.

approve or block major combinations in administrative proceedings.[254] Both the FTC and the Antitrust Division can bring suit alleging civil violations of the antitrust laws.[255] For reasons related more to custom than to relative competency, they have awkwardly divided civil enforcement responsibilities: the FTC brings suits related to energy, healthcare, retail stores, and computer hardware, while the Antitrust Division brings suits related to agriculture, telecom, travel, and computer software.[256] Only the Antitrust Division can bring criminal prosecutions.[257]

The Antitrust Division, as compared to the FTC, is a less attractive option for re-allocation of Sherman Act interpretive power. It is an executive agency authorized to enforce norms but not to create them. Since its head serves at the pleasure of the President, each change in administration brings the potential for new enforcement priorities. Interpretive power over the Sherman Act should go to an independent agency, one more likely to be technocratic, not political, in its execution. The FTC is such an agency.

The FTC is a superior choice also because it already plays a direct role in Sherman Act interpretation since it regulates mergers prohibited by § 2 of the Act.[258] And unlike the Antitrust Division, it already has rulemaking ability. The FTC Act of 1914 created the agency and gave it authority to proscribe "[u]nfair methods of competition in or affecting commerce" and "unfair or deceptive acts or practices in or affecting commerce."[259] But Congress's delegation of rulemaking authority to the FTC was ambiguous in scope, allowing it to "make such rules and regulations" but not specifying whether those rules would be binding.[260] So the delegation has been interpreted to confer only interstitial jurisdiction to the agency; that is, the agency may use its rulemaking authority merely to fill the gaps left by the Sherman Act and the Robinson–Patman Act.[261] In fact, the FTC rarely uses

254. *Id.*; U.S. DEP'T OF JUSTICE & FED. TRADE COMM'N, HORIZONTAL MERGER GUIDELINES (2010), *available at* http://www.justice.gov/atr/public/guidelines/hmg-2010.pdf.

255. *See* ELEANOR M. FOX ET AL., CASES AND MATERIALS ON U.S. ANTITRUST IN GLOBAL CONTEXT 645 (2d ed. 2004) (describing overlapping civil jurisdiction of the Antitrust Division and the FTC).

256. *See* Crane, *supra* note 5, at 1199.

257. *Id.* at 1198.

258. 15 U.S.C. § 18a gives the FTC express authority to regulate mergers under the Clayton Act. Conversely, the FTC's authority to enforce the terms of the Sherman Act is not statutorily granted. However, the FTC Act grants the FTC broad powers to regulate "unfair methods of competition" and "unfair or deceptive acts or practices." 15 U.S.C. § 45(a)(1) (2006). By exercising this power, the FTC can enforce the provisions of the Sherman Act. 1 JOHN J. MILES, HEALTH CARE AND ANTITRUST LAW § 6:13 (2010).

259. JOELSON, *supra* note 252, at 26.

260. Custos, *supra* note 107, at 619 & n.22.

261. Posner, *supra* note 75, at 766.

its power to promulgate such rules under notice-and-comment rulemaking,[262] a fact that prompted Professor Kenneth Culp Davis to say that the agency "should be ashamed" of its flimsy record of rulemaking.[263]

A change in the FTC's statutory authority could change this. Congress could mandate *Chevron* deference for the agency's interpretation of antitrust norms by amending the Sherman Act to confer primary authority over its interpretation to the FTC. The shift in legal regime might seem subtle since the FTC already has antitrust rulemaking authority (if weak and interstitial) under a different statute. But giving the FTC dominion over the Sherman Act, American antitrust's constitution, would mean taking the task of large-scale policy making out of the hands of an inexpert Court whose best access to economic arguments are amicus briefs and placing it in the hands of an institution designed to deal with technical scientific matters thoroughly and transparently.

C. Objections

Giving an agency authority to interpret the Sherman Act in the first instance raises several concerns. First, if Congress were to give an agency the final word on how to implement the vague incantations against monopolization found in the Sherman Act, it might violate the nondelegation doctrine.[264] For an agency's norm-creation power to have any meaning, it would have to include the ability to override past precedent interpreting the Act. A century's worth of jurisprudence on competition policy could be scratched and replaced by any set of rules that purport to invalidate any "combination . . . in restraint of trade,"[265] which, by its plain meaning, could preclude partnership agreements and pedestrian mergers.

Of course, if giving an agency this power violates the nondelegation doctrine, then so does giving the courts this power; the nondelegation doctrine does not only limit delegation by Congress to agencies, but it also

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262. *See id.* at 768–69.

263. KENNETH CULP DAVIS, DISCRETIONARY JUSTICE: A PRELIMINARY INQUIRY 70–74 (1969). The reason for its reluctance is that FTC rules outside of the merger context get little respect from the courts, as evidenced by a recent skirmish between the agency and the Eleventh Circuit over pharmaceutical pay-for-delay settlements. After following procedures that "loosely mimicked the Administrative Procedure Act's requirements for agency rule making," the FTC denounced any "reverse payments" between a branded drug manufacturer and its generic counterpart that exceeded $2 million. The Eleventh Circuit reversed this rule in *Schering-Plough Corp. v. FTC*, 402 F.3d 1056 (11th Cir. 2005), implying that a regulation passed by the FTC must not clash with the Circuit's own precedent. Although the FTC was neither a party nor an amicus to the earlier case in question, the court considered the agency bound by it and so precluded from promulgating a contrary rule. Crane, *supra* note 5, at 1200–01.

264. *See* Oldham, *supra* note 245, at 367–79 (sketching out the history of the nondelegation doctrine and its possible application to the antitrust context).

265. 15 U.S.C. § 1 (2006).

limits delegation to courts.[266] So technically it would be incoherent to say that the delegation of power to an agency violates the nondelegation doctrine while delegation without saying the current state of affairs is unconstitutional. But Congress's delegation of power to the Court in the form of the Sherman Act is so entrenched, and the Court is now so limited by the stare decisis effect of its own decisions, that the delegation is not likely to be seen as controversial. In contrast, advocates of separation of powers might be understandably nervous about redelegating power of competition policy writ large to an agency today writing on a blank slate.

The transfer of power may need to be more piecemeal than that. Instead of amending the Sherman Act to confer broad interpretive authority to the FTC, Congress could pass statutes on individual competition law controversies—like tying, resale price maintenance, and refusals to deal—giving the FTC more guidance about how to prioritize rulemaking. These statutes would be designed to supersede the Sherman Act; they would displace the Court's interpretation of the Sherman Act as it related to the particular practices, while leaving in place less controversial Supreme Court rules under the Act, such as the prohibition on naked price fixing. Or Congress could achieve this same effect by amending the Sherman Act to be more precise in its economic aims.

Second, critics of my plan may object to the removal of antitrust from its populist roots and placing it in the hands of unelected technocrats. After all, "[t]here have been times in American history when antitrust was a magisterial pursuit that stirred the public imagination, exposed visceral ideological impulses, and shaped perspectives on adjacent matters, like labor policy, securities regulation, and taxation."[267] Professor Daniel A. Crane responds to this criticism in an article advocating increased norm-creation powers for the antitrust agencies. He argues that when a field meets three criteria, it is ready for a shift towards technocracy: "consensus on ends, resolution of foundational ideological questions, and the absence of explicit distributive considerations."[268] Antitrust meets these criteria. After Bork,[269] any antitrust policymaker must defend his rule as promoting economic efficiency; there is wide consensus that this is the proper end of antitrust

266. *See* Margaret H. Lemos, *The Other Delegate: Judicially Administered Statutes and the Nondelegation Doctrine*, 81 S. CAL. L. REV. 405, 421–43 (2008) (exploring the practice of delegating lawmaking authority to the Judicial Branch and arguing that this practice deserves more scholarly attention).

267. Crane, *supra* note 5, at 1159–60 (citation omitted).

268. *Id.* at 1161.

269. BORK, *supra* note 177; Robert H. Bork, *Legislative Intent and the Policy of the Sherman Act*, 9 J.L. & ECON. 7 (1966).

regulation.[270] Ideological debate, once prominent in antitrust, has largely given way to debate over economic theory and data.[271] Finally, as Crane argues, antitrust is no longer thought to have a serious redistributive effect—competitive efficiency seeks to expand the pie, not distribute the slices.

V. Conclusion

The Supreme Court is right to turn to amicus briefs in Sherman Act cases because it is there that the Court finds the economic evidence and reasoning that ought to influence antitrust policy. The move is evidence that scholars like Robert Bork and Richard Posner have succeeded in reforming antitrust legal analysis from analogical reasoning to scientifically informed pursuit of efficiency. But the Court can only go so far with its awkward hybrid of adjudication and administrative rulemaking. It is, after all, a court comprised of generalist judges charged with resolving individual cases and controversies. And amicus briefs are an anemic substitute for comments on a rulemaking. The Court's recent mistakes in *Leegin* and *LinkLine*, traceable to its reliance on amici, lend support for a further technocratic shift in Sherman Act rulemaking: a New Deal for antitrust.

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270. *See, e.g.*, Ill. Tool Works Inc. v. Indep. Ink, Inc., 547 U.S. 28, 45–46 (2006) (citing "the virtual consensus among economists" that tying arrangements can be economically efficient in supporting a holding that a plaintiff must affirmatively prove that a tying arrangement confers market power to establish an antitrust violation); RICHARD A. POSNER, ANTITRUST LAW 2 (2d ed. 2001) ("[T]he only goal of antitrust law should be to promote efficiency in the economic sense . . . ."); Alan Devlin, *Antitrust in an Era of Market Failure*, 33 HARV. J.L. & PUB. POL'Y 557, 561–62 (2010) (observing that the view that agencies should protect consumers from market concentration was "most prevalent during the Warren Court era, [but] has been resoundingly rejected by U.S. courts for more than thirty years" and concluding that "[l]ong-run efficiency is the exclusive goal of modern competition enforcement"); Thomas O. Barnett, Assistant Att'y Gen., U.S. Dep't of Justice, Luncheon Address to the Federalist Society, Washington, D.C. (Feb. 29, 2008), *available at* http://www.justice.gov/atr/public/speeches/230627.pdf ("[A]n analytical consensus [on the Supreme Court] has emerged. The Court has accepted the focus on economic efficiency . . . ."). *But see* John B. Kirkwood & Robert H. Lande, *The Fundamental Goal of Antitrust: Protecting Consumers, Not Increasing Efficiency*, 84 NOTRE DAME L. REV. 191, 196 (2008) (rejecting this view in arguing that "[t]he ultimate objective of [antitrust] laws, in short, is to protect consumers, not to increase overall efficiency").

271. *See* Crane, *supra* note 5, at 1164 (observing that antitrust enforcement has ceased being an ideological battleground and has since become a "professional, active, and . . . quietly technocratic and successful enterprise" of legal and economic specialists).

* * *

When the Government Is the Controlling Shareholder

Marcel Kahan & Edward B. Rock*

As a result of the 2008 bailouts, the U.S. government became the controlling shareholder of some major U.S. corporations: AIG, Citigroup, GM, GMAC, Fannie Mae, and Freddie Mac. Corporate law provides a complex and comprehensive set of standards of conduct to protect noncontrolling shareholders from controlling shareholders who have goals other than maximizing firm value. In this Article, we analyze the extent to which these existing corporate law structures of accountability apply when the government is the controlling shareholder and the extent to which federal "public law" structures substitute for displaced state "private law" norms. We show that the Delaware restrictions on controlling shareholders are largely displaced, but hardly replaced, by federal provisions. Having concluded that the existing accountability structures do not provide sufficient protection of minority-shareholder interests, we examine the variety of ways (in the United States and elsewhere) in which government ownership has been structured in order to minimize political interference at the expense of noncontrolling shareholders, including nonvoting stock, independent directors, dedicated trusts, and separate management companies. Because neither ex ante legal structures nor ex post judicial review hold much promise for controlling political interference, we are left with a choice between developing new structures of accountability and bringing this anomalous era of government control to a speedy conclusion. As the U.S. Treasury moves forward with its plans for taking some of these companies public again, understanding the legal restrictions on the government as controlling shareholder is critically important to the decision to buy shares in an IPO and, if so, at what price.

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I. Introduction

General Motors has returned to the public capital markets with an initial public offering of shares. The U.S. Treasury remains and will remain a controlling shareholder of GM for the foreseeable future. To what extent will Delaware law constrain the federal government in its role as controlling shareholder? Will GM's minority shareholders be able to sue the U.S. Treasury for breach of the duty of loyalty if the Treasury abuses its controlling position? This Article addresses these and related issues.

Imagine an essay question for next year's final exam in Corporations:

> Some background: The Detroit Motor Corporation (DMC or DM) is in trouble. Its cost structure is uncompetitive, the quality of its cars is dubious, and, in the midst of a recession, its sales have dropped dramatically. The U.S. government, through the Department of the Treasury, is determined to rescue it and prepared to take extraordinary steps to do so. First, the government makes a substantial loan to DM. Second, it engineers a reorganization by leaning on the major secured creditors—in whom the Treasury happens to own significant stock and warrants—to accept less than the unsecured creditors will end up receiving. In the new DM, the Treasury owns 60% of the common stock. Hundreds of dealers are terminated. Factories are closed. Directors and executives are replaced. Wage rates are frozen. Around the same time, the Treasury rescues the historically related finance company, Detroit Motors Acceptance Corporation (DMAC), and ends up with a 56% controlling interest in DMAC.
>
> Now to the heart of the question: Going forward, the Treasury wants new DM to succeed, both because it believes that the United States needs to preserve its "domestic" automobile industry (and the jobs associated with it) and because, after investing $50 billion, the government wants to get the money back. To further these goals, the Treasury leans on DMAC to provide financing (on preferential terms) to DM, to customers who buy DM cars, and to the remaining DM dealers.
>
> At the same time, the Treasury insists on the following: First, it wants DM to make DM's product mix much greener because it believes that greener cars are the wave of the future. Second, it asks that no further factories be closed in a set of eight states hit hard by the

> recession and, as it happens, identified by the President's chief pollster as most crucial to the President's chances of winning a second term.
>
> Some of the minority shareholders of DMAC are outraged that their company is being run for the benefit of DM. They provide evidence that the preferential terms provided to DM and its dealers and customers cost DMAC about $500 million per year. They would like to sue to recover damages already suffered and to prevent these preferential contracts from continuing. Please advise them on what claims they can bring, against whom, and how they should proceed. Address both substantive and procedural aspects.
>
> Some of the minority shareholders of new DM think that going green will be financially ruinous. They would like to take legal action to prevent the change or, in the event that it goes forward, wonder if they will have any remedy if no one wants to buy new DM's green cars.
>
> Finally, minority shareholders of DM complain about the fact that factories slated for closing seemed to be picked on some basis other than maximizing the corporation's profits.
>
> Please advise them.

For corporate law, the fact pattern raises several issues.[1] First, on account of the size of its shareholding, the U.S. government would be considered a "controlling shareholder" of both DM and DMAC and, thus, would owe fiduciary duties to the respective minority shareholders. All three requests made by the U.S. government—to have DMAC lend money to DM, to revise DM's product mix, and not to have DM close certain factories—raise fiduciary-duty issues.

As to DMAC, one worries that the Treasury has used its power over DMAC to benefit another firm in the Treasury's control, DM, at a cost to the other shareholders of DMAC.[2] In corporate law terms, this raises questions of self-dealing and the duty of loyalty. At the same time, shareholders of DM worry that the Treasury is allowing other considerations—reducing global warming, saving jobs in recession-battered states, or increasing the President's reelection chances—to lead the Treasury to force DM into costly and foolish business decisions that will cost the shareholders huge amounts of money. This raises issues that would normally be analyzed under the duty of care and the duty of good faith.

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1. It also raises a host of other issues that are beyond the scope of this Article, including the fit between Chapter 11's requirements for the approval of a plan of reorganization and the "363 sale" procedure used in the Chrysler and GM bankruptcies, which poses important and unresolved issues under bankruptcy law and issues relating to the effect on competitors of the government's investments in DM and DMAC. *See* Mark J. Roe & David Skeel, *Assessing the Chrysler Bankruptcy*, 108 MICH. L. REV. 727, 734–36, 746–49 (2010).

2. The background section raises a similar issue with regard to the noncontrolling shareholders of the TARP banks. *See infra* subpart II(B).

In posing the corporate law issues, there is an immediate sense that the framework does not quite fit the situation. In the normal self-dealing context, the controlling shareholder enriches itself at the expense of the noncontrolling shareholders. Here, by contrast, the Treasury leans on DMAC to help DM in order to further certain public-policy initiatives. While minority shareholders may well suffer, the Treasury is not lining its pocket on their backs. Although the minority shareholders may object to the Treasury furthering public policy at their expense, that is a different complaint.

The United States does not have much history with government ownership of private industry.[3] As a result, we do not have a well-worked-out structure of accountability when the government is the majority holder of a for-profit corporation. The problems raised are an interesting inverse of the problems caused by privatization of key governmental functions. When prisons, public education, or delivery of social-welfare services are privatized, the normal public law structures of accountability may be displaced. For constitutional or administrative law protections to apply, the threshold requirement is typically "state action," a requirement that may not be met when services are outsourced to private firms. The challenge to public accountability posed by privatization has produced a large literature that examines, in various ways, two main questions: First, is it permissible to outsource particular functions, as a matter of constitutional norms or public law values more generally? Second, if the delegation is permissible, which of the constitutional or administrative law limits, if any, do or should apply to the private actor?[4] In short, can or should the Constitution or the Administrative Procedure Act[5] (APA) reach private actors providing public services?

When the government becomes a controlling shareholder of a private firm, we face an inverted set of these issues. Government involvement, as we will see, changes everything. It immediately raises issues of sovereign immunity and its various and sundry waivers. It forces corporate law scholars to venture into the realms of Administrative Law—the content of the Tucker Act,[6] the Federal Tort Claims Act[7] (FTCA), and the APA. These three federal statutes largely displace Delaware's state law structures of accountability. A key challenge posed by government involvement is

3. For a review of that history, see J.W. Verret, *Treasury Inc.: How the Bailout Reshapes Corporate Theory and Practice*, 27 YALE J. ON REG. 283, 289–93 (2010).

4. For examples of this literature, see generally Jack Beermann, *Privatization and Political Accountability*, 28 FORDHAM URB. L.J. 1507 (2001); Jody Freeman, *The Private Role in Public Governance*, 75 N.Y.U. L. REV. 543 (2000); Gillian Metzger, *Privatization as Delegation*, 103 COLUM. L. REV. 1367 (2003); Symposium, *Public Values in an Era of Privatization*, 116 HARV. L. REV. 1212 (2003); Paul Verkuil, *Privatizing Due Process*, 57 ADMIN. L. REV. 963 (2005).

5. 5 U.S.C. §§ 551–559, 701–706 (2006).

6. 28 U.S.C. §§ 1491–1503 (2006).

7. 28 U.S.C. §§ 2671–2680 (2006).

whether the public law approaches to accountability that government involvement imports can, or can be made to, provide the same sort of protections that have evolved in private law. As we will show, the answer, at least so far, is largely negative. The consequence of this is that when the government is an investor, ex post judicial review under the heading of "fiduciary duties" becomes less effective, and greater attention must be given to the ex ante governance structures used when the government takes an equity position as well as to the potential virtues of precommitment to early exit.

Understanding and evaluating the alternative accountability structures available under public and private law is important for a variety of reasons. First, we are now in a period of public ownership of controlling positions in major private firms, and issues may arise. Second, in understanding the public policy trade-offs involved in decisions to rescue private firms rather than allowing them to fail, the extent to which public ownership may lead to "noncommercial" behavior of the firm, or politically motivated behavior by the controlling shareholder, is a significant factor. Indeed, the resulting structures of accountability must be taken into account in determining how to structure the intervention. Third, understanding the strength or weakness of the constraints on the behavior of the controlling shareholder will be important to those considering investing in controlled firms as those firms seek to raise additional capital or the government seeks to reduce its stake, as in GM's 2010 IPO, and to increase the amount that investors will be willing to pay.[8] Finally, inadequacies of the public law accountability structures may provide reasons to work for an early exit from this hybrid ownership regime. If we do not have an adequate regulatory structure when the government is the controlling shareholder, we can either develop one or, probably better, sell off the government stakes quickly. Recent developments suggest that the government is seeking to exit from its ownership positions just as quickly as it can, consistent with getting an adequate price for its shares.[9]

In this Article, we examine these issues, the extent to which the existing structure of legal regulation addresses them, and the extent to which ex ante transactional structures can prevent them from arising or limit their severity if they do arise.[10] We proceed as follows. In Part I, we review recent events

8. GM made an initial public offering of new stock in November 2010. Sharon Terlep, Randall Smith & Aaron Lucchetti, *GM's IPO May Raise Record Amount*, WALL ST. J., Nov. 17, 2010, http://online.wsj.com/article/SB10001424052748704312504575619004098993666.html.

9. *See, e.g.*, Liz Moyer, *Citi Sale Stokes New Trading Dynamic*, WALL ST. J., Dec. 7, 2010, http://online.wsj.com/article/SB10001424052748703296604576005431476850972.html (discussing the Treasury's sale of its 2.4 billion shares in Citigroup stock and the "expected wave of institutional buying" that followed).

10. For other work on these issues that overlaps to some degree with our analysis here, see Steven M. Davidoff & David Zaring, *Regulation by Deal: The Government's Response to the Financial Crisis*, 61 ADMIN. L. REV. 463, 466 (2009), and Verret, *supra* note 3, at 285–89.

during which the U.S. Treasury invested vast sums in private firms, including both financial and nonfinancial institutions and both publicly traded and privately held corporations, as well as some evidence of politically driven involvement in the managing of companies.[11] In Part II, we examine the challenges posed to the existing structure of legal regulation of controlling shareholders when the controlling shareholder is the U.S. Treasury. With regard to claims against the United States, this requires looking at sovereign immunity and its exceptions, as developed in the FTCA, the Tucker Act, and the APA. We also examine the extent to which one could avoid the reach of sovereign immunity by forgoing suit against the controlling shareholder and limiting the defendants to the directors of the controlled corporations. In Part III, we turn to the ex ante governance structures that have been used to try to control the emergence of these problems. In this context, we look at a variety of U.S. structures, including the previous Chrysler bailout that relied on loan guarantees, as well as more recent use of nonvoting stock, share trusts, and commitments to exit; the United Kingdom's establishment of the wholly owned U.K. Financial Investments Limited to hold and manage its interests in financial institutions bailed out with government funds; and the mechanism used by Israel after the bank share trading scandal in the 1980s resulted in government ownership of its banks. Part IV is a conclusion in which we try to draw preliminary lessons from our recent experience with government ownership and our comparative analyses.

II. Some Recent Background

Our starting hypothetical is not simply the product of fevered imaginations but is based on recent events. In this Part, we briefly review some of those developments.

A. The Government's Holdings in Private Companies: Some Numbers

Since the summer of 2008, the government has invested huge sums into private financial and nonfinancial companies. These investments have taken a variety of forms including debt, nonvoting stock, voting stock, and warrants. Although our focus is on the government as controlling shareholder, the threshold of control is vague. Accordingly, we give a broader overview of the government's recent investments.

1. Voting Stock and Control Positions.

- In September 2008, the Treasury invested $85 billion in AIG, in partial exchange for which it received preferred stock that has 77.9% of the votes and warrants that, if exercised, grant it

11. In describing involvement as "politically driven," we do not intend a value judgment but simply to distinguish it from involvement driven by normal financial motives.

another 2% of the votes.[12] If and when the recapitalization announced on September 30, 2010, is completed, the Treasury will own approximately 92.1% of AIG common stock.[13]

- At Citigroup, in the wake of the preferred-stock share exchange, the Treasury owned around 34% of the outstanding common stock,[14] and after Citi's $17 billion stock issuance, owned 26%.[15] During 2010, the Treasury sold off shares so that, by the end of September 2010, its ownership was down to 12.4%.[16] The Treasury subsequently disposed of its remaining interests.[17]
- As a result of the federally engineered bankruptcy, the United States owns 8% of the equity in new Chrysler.[18]
- As a result of the GM bailout, the Treasury owned 61% of the common stock of new GM.[19] After GM's November 2010 IPO, the Treasury's stake dropped to 26%.[20]
- The Treasury owns 56% of the common stock of GMAC, GM's former financing affiliate.[21]
- The Treasury owns 79.9% of Fannie Mae (FNMA, the Federal National Mortgage Association) and Freddie Mac (FHLMC, the Federal Home Loan Mortgage Corporation), the formerly

12. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Sept. 16, 2008), *available at* http://www.federalreserve.gov/newsevents/press/other/20080916a.htm. For further details, see *infra* notes 240–44 and accompanying text.

13. Pallavi Gogoi & Daniel Wagner, *AIG Bailout Exit Doesn't Resolve Losses from TARP*, BLOOMBERG BUSINESSWEEK, Sept. 30, 2010, http://www.businessweek.com/ap/financialnews/D9IIHADO0.htm.

14. Citigroup, Inc., Quarterly Report (Form 10-Q), at 9 (Nov. 6, 2009).

15. David Enrich & Damian Paletta, *Discord Behind TARP Exits*, WALL ST. J., Dec. 19, 2009, http://online.wsj.com/article/SB10001424052748703323704574602552053952422.html; *see also* Michael Corkery, *The Good, Bad, and Ugly of Citigroup's Botched Stock Sale*, WSJ BLOGS (Dec. 17, 2009), http://blogs.wsj.com/deals/2009/12/17/the-good-bad-and-ugly-of-citigroups-botched-stock-sale/ ("As a result of that capital raise, taxpayers were diluted from a 33% stake in Citigroup to 26% . . . .").

16. *U.S. Treasury to Earn $2.25 Billion on Citi Securities*, REUTERS (Sept. 30, 2010), http://www.reuters.com/article/idUSN3011328720101001.

17. Tom Barkley, *TARP Profit on Citigroup: $12.3 Billion*, WALL ST. J., Jan. 27, 2011, http://online.wsj.com/article/SB10001424052748703293204576105763449264874.html.

18. Press Release, U.S. Dep't of the Treasury, Obama Administration Auto Restructuring Initiative: Chrysler–Fiat Alliance (Apr. 30, 2009), *available at* http://www.treasury.gov/press-center/press-releases/Pages/tg115.aspx.

19. *See* Bill Vlasic & Nick Bunkley, *Obama Is Upbeat for G.M. Future on a Day of Pain*, N.Y. TIMES, June 2, 2009, at A1.

20. Michael J. de la Merced & Bill Vlasic, *U.S. Recovers Billions in Sale of G.M. Stock*, N.Y. TIMES, Nov. 17, 2010, at A1.

21. Binyamin Appelbaum, *U.S. to Give $3.6 Billion More in Aid to GMAC; Move Makes Government the Majority Owner of Troubled Auto Lender*, WASH. POST, Dec. 31, 2009, at A1.

"private" government sponsored enterprises (GSEs) that were the largest mortgage intermediaries.[22]

2. *Debt and Nonvoting Stock.*
   - Through its Capital Purchase Program (CPP), the Treasury injected approximately $200 billion of Troubled Asset Relief Program (TARP) funds into 707 institutions.[23] The CPP investments combine preferred stock with warrants, neither of which carries votes.
   - Through the Targeted Investment Program (TIP), the United States invested $20 billion in nonvoting preferred stock in Bank of America that has now been paid back.[24]

And this is but a partial list of the U.S. government's investments.

B. Some Troubling Anecdotes

This much federal money could not be invested in private companies without controversy and without inviting politicians to take a role, directly or indirectly, in the management of these firms. Even though governmental investment started less than three years ago, there are already some troubling anecdotes that we summarize in this subpart.

Executive compensation, traditionally a matter for the board and shareholders, has attracted a lot of attention in Washington. The outcry over AIG bonuses provides a rich example. After receiving more than $170 billion in bailout funds, AIG announced plans to pay $165 million in bonuses to executives in the company's financial products division, the same division responsible for the collapse of AIG.[25] In response, Representative Earl Pomeroy proclaimed, "Have the recipients of these checks no shame at all? . . . [AIG bonus recipients] are disgraced professional losers. And by the way, give us our money back."[26] Others, such as Representative Charles Rangel, characterized AIG as "getting away with murder,"[27] while Republican Senator Charles Grassley advised AIG bonus recipients to

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22. Louise Story, *New Aid for Fannie and Freddie*, N.Y. TIMES, Dec. 25, 2009, at B1.

23. *Investment Programs: Capital Purchase Program*, U.S. DEP'T TREASURY, http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Pages/capitalpurchaseprogram.aspx.

24. *Investment Programs: Targeted Investment Program*, U.S. DEP'T TREASURY, http://www.treasury.gov/initiatives/financial-stability/investment-programs/tip/Pages/targetedinvestmentprogram.aspx; *see also* Securities Purchase Agreement Between Bank of America Corp. and U.S. Dep't of the Treasury (Jan. 15, 2009), *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/tip/Documents_Contracts_Agreements/BAC%20III%20Binder.pdf.

25. Edmund L. Andrews & Peter Baker, *At A.I.G., Huge Bonuses After $170 Billion Bailout*, N.Y. TIMES, Mar. 15, 2009, at A1.

26. Carl Hulse & David M. Herszenhorn, *A.I.G. and Wall St. Confront Upsurge of Populist Fury*, N.Y. TIMES, Mar. 20, 2009, at A1.

27. *Id.*

"[r]esign or go commit suicide."[28] President Obama, in a more measured response intended to "channel [public] anger in a constructive way,"[29] urged Congress to draft legislation that sends "a strong signal to the executives who run these firms that such compensation will not be tolerated."[30]

But, aside from these predictable and traditional responses to perceived corporate excess, there are a number of more interesting details that illustrate the new dynamics made possible by government ownership. Representative Barney Frank, chairman of the House Financial Services Committee, pushed the idea of suing AIG to get the bonus money back, pointing out that the federal government owns nearly an 80% stake in the company after giving it more than $170 billion in aid.[31] "I still believe that we have a right legally to recover this, because we can assert our ownership rights and say, yes, you may have had a contractual right to a bonus but your rotten performance means you should forfeit it," he was quoted as saying.[32]

Frank's notion that the government may have more power—or, at least, different power—as shareholder than as regulator has been picked up by shareholder activists. At AIG, where a Treasury trust holds 77.9% of the stock, the American Federation of State, County, and Municipal Employees (AFSCME) lobbied the three trustees to withhold the trust's votes from the AIG director who served on the compensation committee during the period in which the bonuses were granted, to vote against AIG's 2008 compensation in the advisory shareholder vote required of TARP participants, and to support AFSCME's shareholder proposal requiring that executive equity awards be held for two years past departure.[33]

But the attempts to influence portfolio companies have been broader. Congress expected that bailout funds would stimulate lending and revitalize

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28. *AIG and the President: Easy Does It*, ECONOMIST, Mar. 21, 2009, http://www.economist.com/opinion/displaystory.cfm?story_id=13326168.

29. Jackie Calmes & Louise Story, *A.I.G. Seeking Return of Half of Its Bonuses*, N.Y. TIMES, Mar. 19, 2009, at A1.

30. Hulse & Herszenhorn, *supra* note 26; *see also* Andrew Ross Sorkin et al., *U.S. Rounding Up Investors to Buy Bad Bank Assets*, N.Y. TIMES, Mar. 23, 2009, at A1 (reporting the Obama Administration's intent to increase oversight of executive compensation at financial institutions). On the legislative side, Congress soon responded to the President's challenge. The House of Representatives passed a bill that retroactively imposed a 90% tax on bonuses paid after January 1, 2009, for traders and executives earning in excess of $250,000 a year. The bill applied to companies retaining $5 billion or more in bailout funds. Representative David Camp said of the legislation, "It is an extreme use of the tax code to correct an extreme and excessive wrong done to the American taxpayer." Hulse & Herszenhorn, *supra* note 26.

31. Foon Rhee, *Liddy: Some "Distasteful" Bonuses Will Be Returned*, BOSTON.COM (Mar. 18, 2009), http://www.boston.com/news/politics/politicalintelligence/2009/03/frank_not_optim.html.

32. *Id.*

33. Letter from Gerald W. McEntee, President, AFSCME, Denise L. Nappier, Treasurer, State of Conn. & Richard L. Trumka, Sec'y Treasurer, AFL-CIO, to Jill M. Considine, Chester B. Feldberg & Douglas L. Foshee, Majority S'holders, AIG (Mar. 31, 2009), *available at* http://www.afscme.org/docs/AIG_Trustee_Letter_3.31_re_Vote_No.pdf.

the economy but later realized that banks were reluctant to lend for fear of continued economic deterioration. As a result, bailout recipients faced mounting pressure from the President and Congress to increase lending. President Obama said he would "hold banks 'fully accountable' for the assistance they receive, and that they 'will have to clearly demonstrate how taxpayer dollars result in more lending for the American taxpayer.'"[34] Senators lashed out at banking executives appearing before the Senate Banking, Housing, and Urban Affairs Committee for using bailout funds for anything other than increasing lending.[35] At a separate hearing before the House Financial Services Committee, Representative Judy Biggert questioned whether "the funds [had] been used to get credit flowing again, not just to financial institutions but to consumers and small businesses."[36] Other committee members "sought promises from the bank executives that they would use the government funds they received to make loans and stimulate the economy, rather than hold onto it to bolster their balance sheets." Representative Michael Capuano implored executives to "get our money out on the street."[37]

Similar calls from Congress soon followed for banks to stem foreclosures and restrain action against struggling homeowners. Barney Frank "acknowledged that struggling homeowners [were not] getting help as fast as many in Congress had hoped"[38] and urged bank executives to put in place a foreclosure moratorium until the government could implement mitigation programs.[39] Frank also criticized hedge fund managers for reportedly directing mortgage servicers to disregard any government program that undercut investment value.[40] Senator Charles Schumer told regulators that "they seemed to be giving the banks 'a little too much dessert and not making them eat their vegetables,'" because banks had not been required to assist homeowners despite receiving bailout funds.[41] In response, many big

34. Christi Parsons & Peter Nicholas, *"We Will Rebuild, We Will Recover,"* L.A. TIMES, Feb. 25, 2009, at A1.

35. Ross Kerber, *Banks Draw Heavy Fire from Capitol Hill*, BOS. GLOBE, Nov. 14, 2008, http://www.boston.com/business/articles/2008/11/14/banks_draw_heavy_fire_from_capitol_hill.

36. Maura Reynolds & Jim Puzzanghera, *Financial Giants' CEOs, Geithner on Hot Seats*, CHI. TRIB., Feb. 12, 2009, at 27.

37. Ross Kerber, *Businesses in N.E. Say Lenders Too Strict*, BOS. GLOBE, Feb. 21, 2009, at A1.

38. Ross Kerber, *Frank Talks About the Economy*, BOS. GLOBE, Oct. 25, 2008, http://www.boston.com/business/articles/2008/10/25/frank_talk_about_the_economy/.

39. Maura Reynolds & Jim Puzzanghera, *Economic Crisis: Lawmakers Give Banks a Scolding*, L.A. TIMES, Feb. 12, 2009, at C5.

40. Kerber, *supra* note 38.

41. David Stout & Brian Knowlton, *Senators Press for Action to Stem Foreclosures*, N.Y. TIMES, Oct. 24, 2008, http://www.nytimes.com/2008/10/24/business/economy/24cong.html?pagewanted=print.

banks put into operation temporary foreclosure moratoriums in advance of the Obama Administration's housing-rescue-plan announcement.[42]

One adaptation to this intense scrutiny has been to preclear any potentially controversial decision with the Treasury or the White House. It was reported, for example, that in the wake of the firestorm of criticism of the AIG bonuses, "senior Treasury officials have been meeting several times a week all spring to review, one by one, the payments to the company's executives. But the time-consuming discussions have never resolved whether any of the executives should get paid."[43] This led to preclearance of even routine bonuses by Kenneth Feinberg, the "compensation czar."[44]

The Treasury ousted Rick Wagoner as GM's CEO on March 29, 2009. He remained an employee of GM until July 14 because it took that long for the Treasury to decide whether he should receive the severance package that the company had promised him.[45]

The GM and Chrysler bailouts have brought an avalanche of political attention. The Senate has held hearings on GM's and Chrysler's plans to reduce their networks of dealerships. As the *Washington Post* summarized, "Empowered by the government's emerging ownership role, members of a Senate committee yesterday excoriated General Motors and Chrysler for their decisions last month to close more than 2,000 dealers."[46] Senator Mark Warner, although acknowledging the dangers of trying to micromanage government-owned companies, nonetheless said that "we've got the right and responsibility to ask these questions."[47] GM and Chrysler also have facilities in many different congressional districts. As the *Washington Post* reported, "Rep. Barney Frank (D-Mass.) said GM management had agreed to postpone a planned shutdown of a parts distribution center in Norton, Mass., after a meeting he had with its chief executive, Fritz Henderson."[48] The political

42. Maura Reynolds & E. Scott Reckard, *Obama Speeds Rescue Plan*, L.A. TIMES, Feb. 14, 2009, at C1.

43. David Cho, *At Geithner's Treasury, Key Decisions on Hold*, WASH. POST, May 18, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/05/17/AR2009051702268.html.

44. Brady Dennis, *AIG Plans Millions More in Bonuses*, WASH. POST, July 11, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/07/11/AR2009071100419.html; *see also* Liam Pleven & Deborah Solomon, *AIG Seeks Clearance to Release Bonuses*, WALL ST. J., July 10, 2009, http://online.wsj.com/article/SB124718910241620823.html.

45. Cho, *supra* note 43; *see also* Bloomberg News, *Ex-GM Chief to Get $8.5 Million in Retirement Pay*, N.Y. TIMES, July 14, 2009, http://www.nytimes.com/2009/07/15/business/15auto.html.

46. Peter Whoriskey & Kendra Marr, *Senators Blast Automakers over Dealer Closings: GM, Chrysler Defend Massive Shutdowns*, WASH. POST, June 4, 2009, at A15.

47. *Id.*

48. Anthony Faiola, *Test-Driving a Foreign Business Model*, WASH. POST, June 22, 2009, http://www.washingtonpost.com/wp-dyn/content/article/2009/06/21/AR2009062101966_pf.html.

involvement continues to intensify.[49] Indeed, in May 2010, GM announced plans to reinstate half of the dealers who challenged GM's terminations.[50]

But it is worth keeping in mind that the government can give as well as take. In a little-noticed ruling at the time of the GM Section 363 sale, the IRS decided, contrary to general practice, that old GM's "net operating loss" tax-carry-forwards would pass to new GM.[51] The effect of this ruling is that the first $45.4 billion of new GM's profits will be tax free.

More recently, the political dance has become even more complex. After a pause during its expedited bankruptcy, government-controlled GM has resumed its lobbying and campaign contributions. Federal Election Commission records indicate that GM contributed $90,500 to lawmakers during the current election cycle.[52] It has also rebuilt its lobbying force, spending $6.9 million in the year following its exit from bankruptcy.[53]

At Citigroup, the ongoing instability in the top management has been attributed to conflicts with federal regulators:

> Mr. Pandit made the changes under pressure from federal regulators and after discussions with Citigroup Chairman Richard Parsons, who has been trying to defuse a standoff between the company and some top federal officials, people familiar with the situation say. The federal government will soon own as much as 34% of Citigroup's shares.[54]

More recently, Citigroup sold its profitable PhiBro subsidiary at a bargain price to avoid a conflict with the Treasury over $100 million in compensation owed to Andrew Sullivan.[55]

The Treasury's political considerations have led it to block profitable actions by controlled firms. For example, at Fannie Mae, the Treasury vetoed a sale of $3 billion in tax credits to Goldman Sachs and Berkshire Hathaway. Although these tax credits were worthless to Fannie Mae, the

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49. *Id.*

50. Nick Bunkley, *G.M. Plans to Reinstate 661 Dealerships*, N.Y. TIMES, Mar. 5, 2010, http://www.nytimes.com/2010/03/06/business/06dealers.html.

51. Randall Smith & Sharon Terlep, *GM Could Be Free of Taxes for Years*, WALL ST. J., Nov. 3, 2010, http://online.wsj.com/article/SB10001424052748704462704575590642149103202.html; *see also* Ted Reed, *What About GM's Tax Losses?*, THE STREET (June 9, 2010), http://www.thestreet.com/story/10510986/what-about-gms-tax-losses.html (quoting a senior administration official as stating that the net operating loss "would be transferred to the new company").

52. Josh Mitchell, *GM Resumes Political Giving*, WALL ST. J., Sept. 22, 2010, http://online.wsj.com/article/SB10001424052748704129204575506352139305206.html.

53. Silla Brush, *GM Rebuilds D.C. Lobbying Force as It Enters Post-bailout Era*, THE HILL (Sept. 21, 2010), http://thehill.com/business-a-lobbying/119885-gm-rebuilds-its-lobbying-force-for-post-bailout-era.

54. David Enrich & Robin Sidel, *Citigroup Shakes Up Leaders to Pacify U.S.*, WALL ST. J., July 10, 2009, http://online.wsj.com/article/SB124714471454017995.html.

55. Eric Dash & Jack Healy, *Citi Averts Clash over Huge Bonus*, N.Y. TIMES, Oct. 10, 2009, http://www.nytimes.com/2009/10/10/business/10citi.html.

Treasury would have lost tax revenues had they been sold to an entity that could use the credits to offset its taxes. In this way, the financial interests of the Treasury and of Fannie Mae and its (nongovernmental) shareholders and creditors were in clear conflict—and the Treasury's interests prevailed.[56]

These anecdotes raise a variety of concerns, two of which we will focus on.[57] First, one worries that the influence or control that comes with a major investment (debt or equity) will be used to achieve goals other than maximizing the value of the firm or ensuring that the debt is repaid. With the polycentric power structure of the federal government, the potential exists for congressional pressure to be brought to bear on firms to adopt policies favored by politicians without regard to whether those policies advance the interests of the firm. The automobile-dealership hearings provide a concrete example: the political pressure could surely convince GM and Chrysler to preserve some politically well-connected dealerships that they otherwise would close.

The second concern is that the resulting governance structure will be dysfunctional. This may be caused by managers' attempts to be responsive to too many different sources of pressure. With pressures from chairs of congressional committees, the White House, and the Treasury, steering the ship forward becomes even more complicated. Additionally, as noted above, to the extent that, for example, the Treasury expects to sign off on significant business decisions and does not have the staff or expertise in place to provide this input in a timely or competent manner, the quality of the decisions may be compromised.

We close this subpart with GM's straightforward articulation of the potential conflicts of interest:

> *The UST (or its designee) will continue to own a substantial interest in us following this offering, and its interests may differ from those of our other stockholders.*
>
> Immediately following this offering, the UST will own approximately 36.9% of our outstanding shares of common stock (33.3% if the underwriters in the offering of common stock exercise their over-allotment option in full). As a result of this stock ownership

56. Nick Timiraos, *Treasury Blocks the Sale of Tax Credits by Fannie*, WALL ST. J., Nov. 7, 2009, http://online.wsj.com/article/SB125754828200334693.html.

57. Government ownership in the United Kingdom has had very similar effects. *See, e.g.*, Dana Cimilluca & Sara Schaefer Munoz, *RBS Draws Fire in U.K. over Its Role in Kraft Deal*, WALL ST. J., Dec. 17, 2009, at C1 (describing Parliament members' objections to government-controlled Royal Bank of Scotland's lending and advisory relationship with Kraft in Kraft's hostile bid for Cadbury); Robert Lindsay & Miles Costello, *RBS Board Keeps Resignation Threat over Bonuses Alive*, TIMES ONLINE, Dec. 15, 2009, http://business.timesonline.co.uk/tol/business/industry_sectors/banking_and_finance/article6957239.ece (describing Royal Bank of Scotland directors' threats to resign if the government took action to reduce the size of the bank's employee bonus pool).

> interest, the UST has the ability to exert control, through its power to vote for the election of our directors, over various matters. To the extent the UST elects to exert such control over us, its interests (as a government entity) may differ from those of our other stockholders and it may influence, through its ability to vote for the election of our directors, matters including:
>
> • The selection, tenure and compensation of our management;
>
> • Our business strategy and product offerings;
>
> • Our relationship with our employees, unions and other constituencies; and
>
> • Our financing activities, including the issuance of debt and equity securities.
>
> In particular, the UST may have a greater interest in promoting U.S. economic growth and jobs than other stockholders of the Company. For example, while we have repaid in full our indebtedness under the UST Credit Agreement, a covenant that continues to apply until the earlier of December 31, 2014 or the UST has been paid in full the total amount of all UST invested capital requires that we use our commercially reasonable best efforts to ensure, subject to exceptions, that our manufacturing volume in the United States is consistent with specified benchmarks.
>
> In the future we may also become subject to new and additional laws and government regulations regarding various aspects of our business as a result of participation in the TARP program and the U.S. government's ownership in our business. These regulations could make it more difficult for us to compete with other companies that are not subject to similar regulations.[58]

C. *How Did We Get Here?*

Government ownership, a product of a fast-moving and fast-changing crisis, is widespread and extremely complicated. Money has been invested through a variety of programs with a variety of restrictions and a variety of goals. As a result, the terms of the government's ownership positions vary widely among portfolio companies. To describe the broad patterns of ownership, we briefly review the chronology and the relevant legislation.

Beginning in the summer of 2007, troubles in the subprime-mortgage sector undermined confidence not just in the asset-backed securities that contained those mortgages but more generally in the credibility of fundamental legal and market structures: the accuracy of the credit ratings, the solvency of the monoline insurers, and the safety and soundness of key fi-

58. GEN. MOTORS CO., PROSPECTUS 27 (2010), *available at* http://www.sec.gov/Archives/edgar/data/1467858/000119312510263635/d424b11.pdf.

nancial institutions. As confidence in market institutions collapsed, and with it confidence in the soundness of counterparties, the credit markets froze.

In response, the Treasury and the Federal Reserve intervened in a variety of ways. In the first stage of intervention, they sought to unfreeze the credit markets by providing additional liquidity. In August 2007, the Federal Reserve, along with the European Central Bank, injected $100 billion for borrowing;[59] in November 2007, it injected another $41 billion;[60] in the Spring of 2008, it cut interest rates[61] and opened the discount window to investment banks.[62]

Second, the Treasury and the Federal Reserve intervened in an ad hoc way to try to prevent failures of systemically important financial institutions. Thus, in March 2008, the Federal Reserve provided financial assistance to J.P. Morgan Chase in the rescue of Bear Stearns.[63] Also during March, the Federal Reserve announced measures to provide liquidity to commercial and investment banks. Later, during the summer of 2008, the Treasury acted to shore up the capital structures of Fannie Mae and Freddie Mac and ultimately put both into conservatorship.[64]

These interventions were controversial. Some argued that the government had no business intervening to save firms and that doing so created moral hazard.[65] Others argued that the interventions were indefensible handouts to the rich and powerful.[66]

Then came the failure of Lehman Brothers on September 15, 2008, and the ensuing panic.

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59. *See* Scott Lanman & Christian Vits, *Central Banks Add Cash to Avert Crisis of Confidence*, BLOOMBERG (Aug. 10, 2007), http://www.bloomberg.com/apps/news?pid=newsarchive&sid=ah7K.eFz9xiU&refer=home (describing emergency measures performed in tandem by central banks to avert a global crisis).

60. Michael M. Grynbaum, *In Wild Swing, Stocks Give Up Rate-Cut Gains*, N.Y. TIMES, Nov. 2, 2007, at A1.

61. Steven R. Weisman, *Fed Cuts Rate but Hints About a Pause*, N.Y. TIMES, May 1, 2008, at C1.

62. Michael J. de la Merced, *Fed Extends Emergency Borrowing Program*, N.Y. TIMES, July 31, 2008, at C12.

63. *See* Marcel Kahan & Edward Rock, *How to Prevent Hard Cases from Making Bad Law: Bear Stearns, Delaware, and the Strategic Use of Comity*, 58 EMORY L.J. 713, 717 (2009) (describing the Fed's involvement in the Bear Stearns collapse).

64. Stephen Labaton & Edmund L. Andrews, *In Rescue to Stabilize Lending, U.S. Takes Over Mortgage Finance Giants*, N.Y. TIMES, Sept. 8, 2008, at A1.

65. *See, e.g.*, Gretchen Morgenson, Op-Ed., *Rescue Me: A Fed Bailout Crosses a Line*, N.Y. TIMES, Mar. 16, 2008, Sunday Business, at 1 (criticizing the Federal Reserve's bailout of Bear Stearns, especially because the bank "operated in the gray area of Wall Street and with an aggressive, brass-knuckles approach").

66. *See, e.g.*, Nouriel Roubini, *Public Losses for Private Gain*, GUARDIAN.CO.UK (Sept. 18, 2008), http://www.guardian.co.uk/commentisfree/2008/sep/18/marketturmoil.creditcrunch (calling the bailouts "the biggest government intervention and nationalizations in the recent history of humanity, all for the benefit of the rich and the well connected").

On September 16, 2008, the Federal Reserve saved AIG by pledging $85 billion in exchange, *inter alia*, for a promise to issue preferred stock with 79.9% of the voting rights.[67] Subsequent amounts were ultimately pledged and invested in AIG.

On October 3, 2008, on its second try, Congress enacted the Emergency Economic Stabilization Act of 2008[68] (EESA), which gave birth to the TARP program. This set the framework for most of the subsequent investments in firms. Within the TARP framework, a variety of programs were launched including the Capital Purchase Program (CPP), used to invest in banks; the Systemically Significant Failing Institutions Program (SSFIP), used for subsequent investments in AIG; the Targeted Investment Program (TIP), used for Citigroup and Bank of America; and the Term Asset-Backed Lending Facility (TALF).

To understand the terms of the government's portfolio, we need to review briefly the key provisions of the EESA. In doing so, it is critical to keep in mind that when enacted, the stated rationale was that TARP funds would be used to purchase toxic assets from troubled financial institutions. But TARP later morphed into a program to invest directly in troubled financial institutions, a direction that was already contemplated even before the EESA was enacted but not disclosed to Congress.[69] It is also critical to recall how difficult it was to pass the EESA and the political obstacles to returning to Congress for additional authority or funding.

With this as background, we turn to the statutory structure. In keeping with the original conception, the EESA authorized the Treasury to buy "troubled assets" from "financial institutions."[70] The Treasury was given additional discretion through the broad definition of *troubled assets*, which potentially included any mortgage or related security as well as any other financial instrument so designated by the Treasury Secretary.[71] Finally, in order to allow taxpayers to benefit from the upside of these purchases, § 113(d) required that when the Treasury purchased troubled assets from a

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67. It was subsequently reduced to 77.9%, with an additional 2% in connection with a warrant.

68. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, 122 Stat. 3765.

69. ANDREW ROSS SORKIN, TOO BIG TO FAIL 508–16 (2009).

70. EESA § 101(a), 122 Stat. at 3767 (to be codified at 12 U.S.C. § 5211(a)).

71. The EESA also provides,

> The term "troubled assets" means—(A) residential or commercial mortgages and any securities, obligations, or other instruments that are based on or related to such mortgages, that in each case was originated or issued on or before March 14, 2008, the purchase of which the Secretary determines promotes financial market stability; and (B) any other financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability, but only upon transmittal of such determination, in writing, to the appropriate committees of Congress.

Id. § 3(9), 122 Stat. at 3767 (to be codified at 12 U.S.C. § 5202).

financial institution, the Treasury must also receive a warrant.[72] Under the terms of § 113(d), the warrant must be for nonvoting shares or, if no nonvoting shares are provided for in the certificate of incorporation, the Treasury must agree not to vote the warrant shares.

As noted above, the bailout strategy shifted decisively away from the purchase of troubled assets to investment in troubled firms. Because the definition of *troubled asset* noted above is very broad[73] and the prohibition on acquiring voting stock only applied to warrant shares and not to the troubled assets themselves,[74] the Treasury had clear authority to buy voting common stock in financial institutions.

This authority was exercised in various ways. In the CPP, which channeled funds to banks, the Treasury chose to acquire nonvoting preferred stock. The Treasury's standard term sheet, developed by private equity lawyers at Simpson Thacher,[75] provided that the senior preferred stock would be nonvoting except for class voting rights on the issuance of more senior securities, on changes to the rights of the senior preferred stock, or on any merger or other transaction that would adversely affect the rights of the senior preferred stock.[76] As described above, in TARP investments pursuant to other programs, the Treasury has sometimes taken voting stock.[77] Finally, there are situations in which the Treasury has switched from nonvoting to voting stock.[78] This has led to a somewhat varied set of terms within the government's portfolio.

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72. In the case of publicly held firms, § 113(d)(1)(A) provides,

> The Secretary may not purchase, or make any commitment to purchase, any troubled asset under the authority of this Act, unless the Secretary receives from the financial institution from which such assets are to be purchased—
>
> > (A) in the case of a financial institution, the securities of which are traded on a national securities exchange, a warrant giving the right to the Secretary to receive nonvoting common stock or preferred stock in such financial institution, or voting stock with respect to which, the Secretary agrees not to exercise voting power, as the Secretary determines appropriate."

Id. § 113(d)(1)(A), 122 Stat. at 3778 (to be codified at 12 U.S.C. § 5223). Similar provisions apply to privately held firms. *Id.* § 113(d)(1)(B).

73. *See supra* note 71 and accompanying text.

74. EESA § 113(d), 122 Stat. at 3778.

75. Press Release, U.S. Dep't of the Treasury, Treasury Hires Legal Adviser Under the Emergency Economic Stabilization Act (Oct. 16, 2008), *available at* http://www.treasury.gov/press-center/press-releases/Pages/hp1217.aspx.

76. U.S. Dep't of the Treasury, TARP Capital Purchase Program: Summary of Preferred Terms 4, *available at* http://www.treasury.gov/press-center/press-releases/Documents/term%20sheet%20%20private%20c%20corporations.pdf; *see also* U.S. Dep't of the Treasury, Securities Purchase Agreement: Standard Terms § 4.6, at 30, *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/cpp/Documents/spa.pdf (referring to the Treasury's commitment not to vote warrant shares).

77. *See supra* section II(A)(1).

78. *See infra* text accompanying notes 87–93.

The government then used TARP to bail out the automobile industry. In December 2008, pursuant to the CPP, the Treasury invested $5 billion in GMAC (which had become a bank holding company in order to qualify for the CPP) in exchange for preferred stock and warrants that did not carry voting rights.[79] The Treasury subsequently created the Automotive Industry Financing Program (AIFP). In May 2009, through the AIFP, the Treasury invested an additional $7.5 billion in GMAC.[80] As of June 2009, the Treasury held 35% of GMAC's equity with the ability to increase that stake to more than 50% through the exercise of warrants.[81] At the end of 2009, the Treasury invested an additional $3.8 billion, increasing its total investment to $16.3 billion and increasing its stock ownership to 56%.[82]

As GMAC became a bank holding company before receiving any TARP funds, the investments fit comfortably within the statutory authority. The use of TARP funds under the AIFP to invest in GM and Chrysler sits on a less secure statutory foundation. Although, as noted above, the statutory definition of troubled asset is sufficiently broad to include common or preferred stock, the statutory definition of "financial institution" is more problematic. In order to have authority to receive TARP funds, it must be the case that GM and Chrysler are, under the statute, financial institutions. The EESA's definition of a financial institution provides in relevant part,

> The term "financial institution" means any institution, including, but not limited to, any bank, savings association, credit union, security broker or dealer, or insurance company, established and regulated under the laws of the United States or any State . . . and having significant operations in the United States, but excluding any central bank of, or institution owned by, a foreign government.[83]

For GM and Chrysler to fit this definition, one must read the phrase "any institution, including, but not limited to" to sweep in institutions that are not financial institutions under any normal understanding of the term. As a matter of statutory interpretation, that argument hardly passes the smell test. As a matter of politics, the Treasury had little choice: Congress had already

79. Edmund L. Andres & Bill Vlasic, *U.S. Agrees to a Stake in GMAC*, N.Y. TIMES, Dec. 30, 2008, at B1.

80. Glenn Somerville, *New Multi-Million Bailout Coming for GMAC: Report*, REUTERS (May 21, 2009), http://www.reuters.com/article/idUSTRE54K6DL20090521.

81. *See* Jordan Fabian, *U.S. to Take Majority Stake in GMAC*, THE HILL (Dec. 30, 2009), http://thehill.com/blogs/blog-briefing-room/news/73969-federal-government-to-take-majority-stake-in-gmac (describing the Treasury's increase in ownership stake in GMAC from 35% to 56%).

82. Nick Bunkley, *Treasury to Give 3.8 Billion More to GMAC in a Third Taxpayer Bailout*, N.Y. TIMES, Dec. 30, 2009, http://www.nytimes.com/2009/12/31/business/31gmac.html?_r=2&emc=eta1.

83. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, § 3(5), 122 Stat. 3765, 3766–67 (to be codified at 12 U.S.C. § 5202(5)).

rejected a request to authorize funds to bail out the auto industry[84] and had only passed the EESA on its second try. But however thin the basis under the EESA, it did not help the secured bondholders who objected in the Chrysler bankruptcy; they found out that they did not have standing to make the argument.[85]

Through its TARP investments, the Treasury currently has an 8% voting stake in new Chrysler[86] and a 26% voting stake in new GM.[87]

In this fluid situation, the size and nature of the government's interest can change. In the fourth quarter of 2008, the Treasury invested $45 billion in Citigroup in exchange for nonvoting perpetual preferred stock and warrants convertible into 6.2% of Citigroup's voting stock.[88] The exercise price of the warrants is well above current stock price, and none have so far been exercised.[89] On February 27, 2009, in order to increase its "core" Tier 1 capital, Citigroup announced plans for an exchange offer to exchange preferred stock for common stock. As part of this exchange offer, the Treasury agreed to exchange up to $25 billion of its preferred stock for common stock on a dollar-for-dollar basis with other holders of preferred stock.[90] After the completion of the exchange offer, the Treasury owned approximately 34% of Citigroup's outstanding common stock, not including the exercise of warrants issued as part of the TARP investment.[91] This, of course, can change: Citigroup recently raised $17 billion in new common equity while the Treasury was unsuccessful in selling its stake, leaving the Treasury's stake, after the dilution from the new stock issuance, at 26%.[92] In

84. David M. Herszenhorn & David E. Sanger, *Senate Abandons Automaker Bailout Bid*, N.Y. TIMES, Dec. 12, 2008, at A1.

85. *See In re* Chrysler LLC, 405 B.R. 79, 83 (Bankr. S.D.N.Y. 2009) ("[T]he Court finds that the Indiana Funds do not have standing under EESA to challenge the actions of the U.S. Treasury pursuant to TARP.").

86. Amended and Restated Limited Liability Company Operating Agreement of Chrysler Group LLC (June 10, 2009) (Schedule of Members), *available at* http://www.treasury.gov/initiatives/financial-stability/investment-programs/aifp/Documents_Contracts_Agreements/Chrysler%20LLC%20Corporate%20as%20of%2012-01-10.pdf; *see also* Press Release, U.S. Dep't of the Treasury, *supra* note 18 (referencing the Treasury's plan to receive 8% of the equity of Chrysler).

87. Merced & Vlasic, *supra* note 20.

88. Citigroup, Inc., Annual Report (Form 10-K), at 6, 9, 44 (Feb. 22, 2008) [hereinafter Annual Report]; *see also* Citigroup, Inc., Proxy Statement 1, 19 (Mar. 20, 2009) [hereinafter Proxy Statement].

89. Proxy Statement, *supra* note 88, at 1.

90. Citigroup, Inc., Exchange Offer (Form S-4), at 37 amend. 4 (June 18, 2009); *see also* Annual Report, *supra* note 88, at 45.

91. Citigroup, Inc., *supra* note 14, at 9.

92. *See supra* note 15 and accompanying text.

further sales during 2010, the Treasury disposed of the remainder of its stake.[93]

D. Purpose Versus Effect of Acquiring Stock Position

So, through a variety of routes, the Treasury has ended up with equity investments in private firms. These range from relatively small nonvoting positions to controlling stakes.

There is no evidence that the government took these positions *in order to* gain control. First, as noted above, the original expectation was that the Treasury would be acquiring troubled assets, not equity stakes. The language of the EESA, as well as its legislative history, make clear that the Treasury took warrants in order to be able to profit from any increases in share value. The cleanest and easiest way for the taxpayers to share in the upside of these investments, without exercising control, was through warrants for nonvoting stock.

Moreover, as the sole available lender and as the regulator of many of these entities, the government already had significant power. In the short term, voting rights may not have added much. As the largest, and probably only, willing lender and with the normal covenants (no dividends, veto over acts or transactions that could impair the value of the nonvoting preferred stock, etc.), the Treasury already had significant control.

But, although only the looniest bloggers would claim that this was all a plot to foist socialism on America,[94] the result of these various initiatives has been, as noted above, that the Treasury now has significant ownership stakes in a variety of firms. And with control comes the temptation and opportunity to interfere. As the earlier illustrations show, once the Treasury owns large or controlling equity stakes in firms, there is a temptation to use those stakes as instruments of control. If Barney Frank can prevent GM from closing a parts distribution facility in his district, he will save the jobs of his constituents, and this may be worthwhile even if it interferes with GM's plans to trim costs. While the *incentive* to interfere is obvious, the structure of this temptation has several features.

First, an equity position, especially a control block, can provide the *power* to interfere. Indeed, because there are so many different means by which a controlling shareholder can exercise control, it rarely must do so. Usually, it is enough for the control shareholder simply to indicate its

93. Randall Smith, Aaron Lucchetti & Michael R. Crittenden, *U.S. Unloads Citi Stake for a $12 Billion Profit*, WALL ST. J., Dec. 7, 2010, http://online.wsj.com/article/SB10001424052748704156304576003884177348202.html.

94. *See, e.g.*, Georg Thomas, *GM Symbol of USA: Obama's Vulture Socialism*, REDSTATEECLECTIC (June 4, 2009), http://redstateeclectic.typepad.com/redstate_commentary/2009/06/gm-symbol-of-usa-obamas-vulture-socialism.html ("Obama is the figurehead of the accelerating takeover of the United States by vulture socialists.").

preference and the managers will acquiesce. Real power need never be overtly exercised. Although it may be that the federal government has sufficient regulatory power to intervene across the full range of issues, a control block provides a different *kind* of power: a power that, depending on how it is structured, can be exercised more informally and with more discretion, outside of the formal regulatory process and the accompanying public scrutiny, and more directly by politicians rather than by appointed bureaucrats.

Second, stock ownership provides periodic *opportunities* to interfere. Every year, shareholders elect directors and vote on shareholder proposals, compensation plans, auditors, etc. A controlling shareholder's vote will typically be decisive.[95] As a result, once one has control, one has virtually no choice but to decide critical issues. At AIG, where a trust holds the Treasury's 77.9% stake, the AIG trustees simply cannot avoid deciding who will be the directors. If they do not attend the meeting, in person or by proxy, no actions can be taken for lack of a quorum. If they do attend, their vote is decisive. When AFSCME submits a shareholder proposal at AIG, the AIG trustees' decision on how to vote the Treasury's shares will determine whether the proposal is approved or rejected.

Finally, an existing stock position minimizes the political *cost* of interference. To be sure, in times of crisis—like the last three years—the government as regulator and lender of last resort has ample power over companies to have its way without any stock ownership at all. The Obama Administration could get rid of GM CEO Rick Wagoner by a mere suggestion, even without any stock ownership. The White House and the Treasury surely had the power to force Bank of America's CEO Ken Lewis to step down, even without stock ownership.[96] But this power dissipates quickly. In ordinary times, firms will have allegiances with congressional forces, and the political cost of executive interference with internal firm decisions will be high. When, for example, in the wake of Enron and accounting scandals, a Republican administration sought to rein in Fannie Mae and Freddie Mac, their strong Congressional support protected them from interference. The power and periodic opportunities provided by stock ownership will change the cost of interference during ordinary times, even if it will not eliminate those costs.

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95. Unless one has precommitted to mirror voting, as for example, the Treasury did at Citigroup over certain matters. *See infra* note 259 and accompanying text.

96. *See Bank of America and Merrill Lynch: How Did a Private Deal Turn Into a Federal Bailout? Part III: Joint Hearing Before the H. Comm. on Oversight and Gov't Reform and the Subcomm. on Domestic Policy of the H. Comm. on Oversight and Gov't Reform*, 111th Cong. 24–25 (2009) (statement of Henry M. Paulson, Secretary of the Treasury) (detailing the process by which Bank of America's management could be removed and acknowledging that Paulson threatened removal); Dan Fitzpatrick, *U.S. Regulators to B of A: Obey or Else*, WALL ST. J., July 16, 2009, http://online.wsj.com/article/SB124771415436449393.html#mod=testMod (discussing the influence that the government exerted upon Bank of America).

III. When the Government Is the Controlling Shareholder: Regulation

A. The Baseline: The Problems Posed by Ordinary Controlling Shareholders

Delaware corporate law has long been suspicious of controlling shareholders. Under Delaware law, a shareholder is "controlling" if either the shareholder controls a majority of the votes in a corporation or if the shareholder controls less than a majority but there is evidence that the shareholder exercises control over the board (if, for example, the directors defer to the views of the shareholder).[97]

If a shareholder is viewed as controlling, there are two consequences. First, that shareholder is deemed to owe fiduciary duties to the remaining "minority" or "noncontrolling" shareholders.[98] These duties extend to the shareholder's action in influencing board or management decisions[99] but not to its actions in voting its shares.[100]

Second, special rules apply to the legal standard for alleged breaches of fiduciary duties—at least some breaches. Transactions that do not enjoy the protection of the business-judgment rule—because they entail self-dealing, involve other material conflicts of interest, or were arrived at in a grossly negligent matter—are evaluated under the entire-fairness standard with the burden of proving entire fairness on the defendant directors (or the defendant controlling shareholder).[101] But generally, if, after full disclosure, these transactions are approved by a majority of disinterested and independent directors or disinterested shareholders, the business-judgment rule is

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97. RODMAN WARD, JR. ET AL., FOLK ON THE DELAWARE GENERAL CORPORATION LAW § 151.5.1 (5th ed. 2006) (citing *In re* Tri-Star Pictures, Inc., 634 A.2d 319, 328 (Del. 1993), and Ivanhoe Partners v. Newmont Mining Corp., 535 A.2d 1334, 1344 (Del. 1987)); *see also* Emerald Partners v. Berlin, 787 A.2d 85, 94 (Del. 2001) ("'[A] shareholder who owns less than 50% of a corporation's outstanding stock, without some additional allegation of domination through actual control of corporat[e] conduct, is not a "controlling stockholder."'" (quoting Emerald Partners v. Berlin, 726 A.2d 1215, 1221 n.8 (Del. 1999))); Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1114 (Del. 1994) (holding that Alcatel was a controlling shareholder because it held a 43.3% stake in Lynch and controlled Lynch's business affairs); *In re* Cysive, Inc. S'holders Litig., 836 A.2d 531, 551–53 (Del. Ch. 2003) (holding that Cysive's CEO, though a minority shareholder, was nevertheless the controlling shareholder because he was the founder, CEO, had family members in executive positions, and controlled enough shares to cast the decisive vote in any contested matter).

98. WARD ET AL., *supra* note 97, at § 151.5.1.

99. *Ivanhoe Partners*, 535 A.2d at 1344.

100. *See* HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 240, at 653 (3d ed. 1983) (clarifying that shareholders can vote as they desire because their shares are their private property).

101. For a discussion of the shifting burden of persuasion under the entire-fairness standard, see Bud Roth, *Entire Fairness Review for a "Pure" Breach of the Duty of Care: Sensible Approach or Technicolor Flop?*, 15 DEL. L. REV. 145, 165–67 (2000). *See also* Cathy L. Reese & Kelly A. Herring, *Recent Developments in Delaware Corporate Law*, 7 DEL. L. REV. 177, 192, 197 (2004) (summarizing cases where the entire-fairness burden was at issue).

reinstated, and the transaction must pass only the (lenient) standard of waste.[102] Such approvals are also referred to as "cleansing acts."[103]

However, if the transaction involves a controlling shareholder, the rules on cleansing acts are different. First, as to approval by disinterested directors, the court mandates stricter conduct before their approval "counts." In particular, it is not sufficient that these directors are technically disinterested and independent; they must also devote substantial care to evaluating the transaction, must have the power to say no, and must employ appropriate processes (including, when warranted, the hiring of independent legal and business advisors). Second, as to the effect of the cleansing act (if the approval counts), it does not reinstate the business-judgment rule but merely shifts the burden of proving entire fairness to the plaintiffs (who have to prove that the transaction was not entirely fair).[104]

The reason for the skepticism about approval by independent directors is reasonably clear. After all, a majority shareholder controls the board composition and thus effectively appoints the directors and can remove them at any time, and the directors know it. Even nonmajority controlling shareholders have substantial influence over board composition. Directors have sometimes shown excessive deference to controlling shareholders, leading to some skepticism on just how independent the directors can or will be.[105] In the Delaware case law, controlling shareholders have been likened to "800-pound gorilla[s]" who are so intimidating that they always get their way.[106]

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102. WARD ET AL., *supra* note 97, § 151.5.4 (citing Harris v. Carter, 582 A.2d 222, 235–36 (Del. Ch. 1990)).

103. *See* David B. Feirstein, Note, *Parents and Subsidiaries in Delaware: A Dysfunctional Standard*, 2 N.Y.U. J.L. & BUS. 479, 488 (2006) (citing Weinberger v. UOP, Inc., 457 A.2d 701, 703 (Del. 1983)) ("[T]he court noted that an informed vote of a majority of disinterested shareholders (a 'Cleansing Act') could serve to shift this burden of proving entire fairness (or the lack thereof) to the plaintiff . . . .").

104. *See, e.g.*, Kahn v. Lynch Commc'n Sys., Inc., 638 A.2d 1110, 1117 (Del. 1994) (holding that approval by disinterested directors shifts the burden of proof to the plaintiff but does not change the entire-fairness standard). There is some ambiguity in the Delaware case law. *Compare* Kahn v. Tremont Corp., 694 A.2d 422, 428 (Del. 1997) (stating, in the context of a self-dealing transaction involving the controlling shareholder, that approval by a properly functioning committee of independent directors would shift the burden of the entire-fairness standard to plaintiffs), *with* Orman v. Cullman, 794 A.2d 5, 20 n.36 (Del. Ch. 2002) (stating, in the context of a merger involving a material conflict of interest on the part of the controlling shareholder, that entire fairness applies *ab initio* to "a squeeze out merger or a merger between two companies under the control of a controlling shareholder"). *Orman v. Cullman* thus raises the possibility that entire fairness does not apply to *all* transactions involving controlling shareholders but only to a subset.

105. *See, e.g.*, *In re* Emerging Commc'ns, Inc. S'holders Litig., No. Civ.A. 16415, 2004 WL 1305745, at *33–35 (Del. Ch. May 3, 2004) (describing shareholders' contentions that the board was unfairly beholden to the controlling shareholder in approving an unfair privatization).

106. *See In re* Pure Res., Inc. S'holders Litig., 808 A.2d 421, 436 (Del. Ch. 2002). In the words of one court,

> The Supreme Court [in *Kahn v. Lynch Communication Systems, Inc.*] concluded that even a gauntlet of protective barriers like those would be insufficient protection because of (what I will term) the "inherent coercion" that exists when a controlling

As to the approval by disinterested shareholders, the stated reason for the skepticism is that shareholders may be afraid of retaliation by the controlling shareholder if they fail to grant their approval. A second, unstated reason is that shareholders, without the benefit of the advice of trusted independent directors and subject to shareholders' own collective-action problems, may make too many mistakes in their approval to justify restoring business-judgment review.

B. The Problem of the Government as a Controlling Shareholder

Whatever the poundage of a regular, private controlling shareholder, the problems created—and the weight of the corresponding gorilla—are potentially magnified when the controlling shareholder is the U.S. government. First, for many of the companies in which the U.S. government has obtained a controlling stake, the influence of the government extends beyond its influence as a large shareholder. For banks and other financial companies, the government also acts as the principal regulator.[107] In companies such as AIG, GMAC, and Citigroup, the government also has a significant stake as a creditor and may be the sole source of additional capital. And for any company, regardless of industry, the potential exists that the government will pass new types of regulation. This potential is not far-fetched. Companies that were recipients of federal TARP funds—several of which were pushed by the government to take these funds—found themselves subject to a new law, not applicable to other companies, that forced them to either limit the amount of executive compensation or submit their compensation to an advisory shareholder vote. Because the government holds so many levers—as large shareholders, as present and potential future regulator, and sometimes as lender and creditor—it is potentially a much bigger gorilla than a regular, private controlling shareholder.

Second, conflicts between the controlling shareholder and the minority shareholders are much harder to monitor when the controlling shareholder is

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> stockholder announces its desire to buy the minority's shares. In colloquial terms, the Supreme Court saw the controlling stockholder as the 800-pound gorilla whose urgent hunger for the rest of the bananas is likely to frighten less powerful primates like putatively independent directors who might well have been hand-picked by the gorilla (and who at the very least owed their seats on the board to his support).

Id.

107. On the influence this can give, see, for example, SORKIN, *supra* note 69, at 524–25. In a meeting with major bank CEOs, Treasury Secretary Paulson insisted that the banks accept TARP money, whether they wanted it or not. When Richard Kovacevich, CEO of Wells Fargo, resisted, Sorkin reports,

> Paulson told him, "Your regulator is sitting right there." John Dugan, comptroller of the currency, and FDIC chairwoman Sheila Bair were directly across the table from him. "And you're going to get a call tomorrow telling you you're undercapitalized and that you won't be able to raise money in the private markets."

Id. at 525.

the government. For regular, private controlling shareholders, the conflicts of interests are predominantly financial. Such conflicts arise in so-called self-dealing transactions—where the controlled entity deals either directly with the controlling shareholders or with another entity in which the controlling shareholder has an interest—or in conflicts transactions—where the controlling shareholder stands to receive some financial benefit that is not proportionally shared with the minority shareholders. Self-dealing transactions and conflicts transactions (if the conflict is material) are subject to review for their entire fairness.

The U.S. government and its various parts, however, have a wide variety of interests other than financial ones. Indeed, the predominant worry when the government is the controlling shareholder will not be that the government wants to enrich itself financially at the expense of the minority shareholders but that the government will induce the corporation to pursue political or policy goals rather than maximize the corporation's value for the proportionate benefit of all of its shareholders. This greatly complicates the task of courts. Self-dealing transactions and material-conflicts transactions are relatively easy to identify by objective standards. By contrast, to determine whether a transaction serves the government's political goals is much harder. The government's political goals are both amorphous and far-reaching, so that a large number of transactions can plausibly be argued to serve these goals. Unless all of these transactions are subjected to entire-fairness review, the court would have to determine whether the goal is important enough and whether the transaction furthers it sufficiently to warrant stricter scrutiny. Because neither of these factors is easily or objectively quantifiable, this is a difficult task.

Finally, review of such conflicts is rendered more difficult because the government is not a unitary actor. Private controlling shareholders, of course, are also not unitary actors when they are corporations. But authority within corporations is hierarchical, so if one agent of the controlling shareholder corporation acts (i.e., asking the CEO or the board to take a certain action), her actions can fairly be attributed to the corporation under normal agency law principles. If the government is the controlling shareholder, however, there are problems with such attribution. Start with actions by members of the Executive Branch and assume that the controlling stake is held somewhere in the Treasury. Should all actions by members of the Executive Branch be attributed to "the government," only those actions originating in the Treasury, or only those originating from the office within the Department that holds the controlling stake (or anyone above it)? What if a regulatory agency (within or without the Treasury) requests that the CEO take certain action? What if that regulator "reminds" the CEO of the government's interest as a shareholder?

Issues are even more complicated if the request for an action originates in the Legislative Branch. Members of Congress can clearly have substantial

influence over the executives, and management of the controlled company is well aware of that. When influential members of Congress request that executives of a controlled company take particular actions, the requests will carry special weight because the government is a controlling shareholder. Yet, it is unclear how these requests ought to be treated for purposes of Delaware law.

Cutting in the other direction, government interference is likely to have different goals than will the classic, overreaching private shareholder who seeks private gain. When the government interferes, it will typically be in order to further some conception of the public interest or to reward a favored actor. In either case, it is not directly lining its own pocket. As we will discuss below, these differences make the fit with Delaware doctrine particularly awkward.

C. Introduction: The Delaware Corporate Law Structure

Return to our original hypo: the government, the controlling shareholder of DMAC with 56% of the votes, leans on DMAC to lend to DM and its dealers and customers on preferential terms in order to benefit DM with a potential cost to DMAC shareholders. Moreover, the Treasury, with 60% of the votes, leans on DM to make its product line more environmentally friendly.

To understand the distinctive challenges posed by government ownership, we first review the analysis when it involves only private parties. Under current Delaware law, the hypo poses obvious duty-of-loyalty and potential duty-of-care problems. Under the duty of loyalty, the controlling shareholder faces a conflict of interest between its interests in DMAC and its interests in a separate corporation, DM. The key questions under the duty of care are whether the controlling shareholder, in forcing DM to change its product mix, has breached any duty and, if so, whether the controlling shareholder has been or could have been exculpated or indemnified against damages.

1. The Duty-of-Loyalty Claim.—The treatment of this sort of conflict is well developed under Delaware corporate law. A shareholder of DMAC would bring a derivative action in Delaware Chancery Court on behalf of DMAC against the controlling shareholder (assuming that the controlling shareholder had enough contacts with Delaware to support personal jurisdiction), the controlling shareholders' designees/employees on the board of directors, and, for good measure, the other directors as well, alleging breach of the duty of loyalty.

As in any derivative suit, demand on the board is required unless it would be excused as futile. In this case, demand would probably be excused.

Ordinarily, Delaware courts apply the so-called *Aronson*[108] test to determine demand futility. Under *Aronson*, a derivative plaintiff must allege specific facts that create a reasonable doubt as to (1) whether a majority of the board is disinterested or independent, or (2) whether the challenged transaction was the product of the board's valid exercise of business judgment.[109] When there is a private controlling shareholder, demand will often be excused under the first prong because directors either have an interest in the transaction or have other business relationships with the controlling shareholder.[110] If the self-dealing transaction involving a controlling shareholder is substantively analyzed under the entire-fairness test—and thus *not* protected by the business-judgment rule—there is a good argument that demand is excused under the second prong of *Aronson*.[111]

If demand were excused, the court would independently evaluate both the financial terms of the transaction and the process leading up to the transaction to determine if both comply with the entire-fairness standard. In short, if the transaction were unfair, there is a significant likelihood that the plaintiffs would succeed in either enjoining the transaction or recovering damages. The robust protections provided by the duty of loyalty are a function of relatively clear rules enforced by private injunctive and damages actions.

This is not a hard case under Delaware law. With its long-standing focus on controlling self-dealing by interested directors and controlling shareholders, Delaware has encountered and analyzed a dizzying range of variations on this basic fact pattern and has developed an intricate set of doctrines that discourage and deter interested fiduciaries from exploiting their control for nonfirm purposes. In the private context, when, as here, the controlling shareholder has, by hypothesis, directly interfered in order to force a transaction with a related party on preferential terms and without any independent negotiating structures or noncontrolling shareholder approval, the liability of the controlling shareholder is so clear that one rarely encounters such behavior.

2. The Duty-of-Care Claim.—Let us assume that the DM shareholders turn out to be right that the Treasury's insistence that new DM make its product mix much greener is a catastrophic business decision that costs DM

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108. Aronson v. Lewis, 473 A.2d 805 (Del. 1984).

109. *Id.* at 814–15.

110. *See, e.g.*, Kahn v. Tremont Corp., No. 12339, 1994 WL 162613, at *4–5 (Del. Ch. Apr. 21, 1994) (finding a group of directors interested for purposes of *Aronson*'s first prong because of their various business ties to the controlling shareholder).

111. To our knowledge, no case directly endorses or rejects the proposition that demand is automatically excused under the second prong of *Aronson* for self-dealing transactions with controlling shareholders that, under *Kahn v. Lynch Communication Systems, Inc.*, are always subjected to entire-fairness review. For a further discussion of this point, see Marcel Kahan & Edward Rock, *When the Government Is the Controlling Shareholder: Implications for Delaware*, 35 DEL. J. CORP. L. 409, 415 (2010).

billions of dollars. Moreover, let us assume that, in retrospect, the decision was grossly negligent by any measure: there were no market tests to support the prediction that American consumers would buy such cars from DM; the controlling shareholder had no expertise and no experts with regard to either the development, engineering, manufacturing, or marketing of automobiles—much less green automobiles; and the decision was rushed through with little deliberation and over the (muted) opposition of long-time executives and directors. The shareholders would now like to sue. Do they have a decent claim under existing Delaware law?

This part of the hypo is obviously designed to raise a straightforward duty-of-care question. There are four parts of the analysis: first, whether the controlling shareholder in the hypo owes a duty of care; second, whether the shareholder's actions violate the duty of care; third, whether any liability for a violation has been exculpated or otherwise immunized; and fourth, even if it has, whether injunctive relief is available.[112]

On the first point, Delaware law is clear that when a controlling shareholder exercises control over business decisions, the shareholder takes on the same duties of care that other fiduciaries have.[113]

As to the duty-of-care analysis itself, as recent cases from Delaware confirm, *Smith v. Van Gorkom*[114] still provides the standard for liability under the duty of care: gross negligence.[115] The hypo paints the unrealistic situation in which the decision-making process is grossly negligent (if, as stated above, the negligence is not gross enough, modify it however you wish).

This then moves us to the third issue, namely, whether this conduct could be exculpated under section 102(b)(7).[116] Although current Delaware case law wrestles with identifying the border between gross negligence (which can be exculpated) and bad faith (which cannot),[117] the hypo can be decided on a simpler basis: section 102(b)(7) does not apply to a controlling shareholder. By its terms, it only permits exculpation of directors.[118]

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112. As the suit would be derivative, the preceding discussion on whether demand would be excused applies.

113. Cinerama, Inc. v. Technicolor, Inc., No. 8358, 1991 WL 111134, at *19 (Del. Ch. June 24, 1991) ("[W]hen a shareholder, who achieves power through the ownership of stock, exercises that power by directing the actions of the corporation, he assumes the duties of care and loyalty of a director of the corporation."), *aff'd in part, rev'd in part on other grounds sub nom.* Cede & Co. v. Technicolor, Inc., 634 A.2d 345 (Del. 1993); *see also* Pfeffer v. Redstone, 965 A.2d 676, 691 n.52 (Del. 2009) (citing *Cinerama, Inc.* approvingly for this proposition).

114. 488 A.2d 858 (Del. 1985).

115. *See, e.g.*, MCG Capital Corp. v. Maginn, No. 4521-CC, 2010 WL 1782271, at *21 n.129 (Del. Ch. May 5, 2010) (citing *Van Gorkom*, 488 A.2d at 873) ("Typically one cannot prove a breach of the duty of care without demonstrating that the directors were grossly negligent with respect to a particular transaction.").

116. Lyondell Chem. Co. v. Ryan, 970 A.2d 235, 239 (Del. 2009).

117. *Id.* at 239–42.

118. DEL. CODE ANN. tit. 8, § 102(b)(7) (2009).

A more interesting issue is posed if we assume that the controlling shareholder is indemnified by DMAC.[119] Under Delaware law, two problems stand in the way of such indemnification. First, under section 145, indemnification is only permitted for a person who is sued "by reason of the fact that the person is or was a director, officer, employee or agent of the corporation."[120] In our hypo, it is not obvious that the controlling shareholder is an agent of the corporation and, by design, is not a director, officer, or employee. Second, indemnification is limited to situations in which the person "acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation."[121] This latter analysis poses some of the same questions regarding the line between gross negligence and bad faith that have been featured in the Delaware case law on section 102(b)(7).[122]

Finally, even if the controlling shareholder is somehow indemnified against liability, injunctive relief against grossly negligent conduct is still available, at least in principle. Although there are no recent examples of injunctions granted in remotely similar situations,[123] the courts have shown a willingness to enjoin what are, in essence, duty-of-care violations in the mergers-and-acquisitions context, as, for instance, when a transaction is enjoined because directors have not complied with their *Revlon* duties, even if the same conduct will not be considered bad faith for purposes of exculpation.[124]

3. The Duty-of-Good-Faith Claim.—The request by the Treasury that DM not close factories in certain states that are deemed important either to national economic policy or to the President's reelection is hardest to categorize under Delaware law. One could argue that the Treasury is subject to a material conflict of interest, albeit not a financial one, and thus has the bur-

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119. If new DM goes bankrupt again because of its switch to green cars, the indemnification—even if permitted—will not be of any use.

120. DEL. CODE ANN. tit. 8, § 145(a).

121. *Id.*

122. *See, e.g.*, *Lyondell*, 970 A.2d at 240 (discussing the "range of conduct" that encompasses bad faith and gross negligence).

123. For an example in which a court refused to enjoin a fairly transparently foolish business decision, see Shlensky v. Wrigley, 237 N.E.2d 776, 781 (Ill. App. Ct. 1968).

124. *See, e.g.*, Malpiede v. Townson, 780 A.2d 1075, 1095 (Del. 2001) (noting that a section 102(b)(7) waiver "would not affect injunctive proceedings based on gross negligence"); Paramount Commc'ns, Inc. v. QVC Network, Inc., 637 A.2d 34, 35–37, 56–58 (Del. 1994) (affirming a preliminary injunction granted for the breach of so-called *Revlon* duties); Leslie v. Telephonics Office Techs., Inc., 1993 WL 547188, at *9 (Del. Ch. 1993) ("[T]o the extent plaintiffs seek equitable relief for any alleged breaches of the duty of care, . . . [a section 102(b)(7) waiver] would not bar them."); *cf.* E. Norman Veasey et al., *Delaware Supports Directors with a Three-Legged Stool of Limited Liability, Indemnification, and Insurance*, 42 BUS. LAW. 399, 403 (1987) (arguing that, in spite of section 102(b)(7), the duty of care "will continue to be vitally important in injunction and rescission cases").

den of showing the entire fairness of the factory-closing policies it is pursuing. While this is doctrinally cogent, we think that the better analytical category for this action can be found in the newly developed Delaware jurisprudence on bad faith. Actions taken in bad faith are not protected by the business-judgment rule (nor insulated from liability under section 102(b)(7)) and are a subcategory of breaches of the duty of loyalty.

In the recent Delaware Supreme Court opinion *Stone v. Ritter*,[125] the court elaborated on the concept of bad faith. It explained that bad faith may be shown where

> [t]he fiduciary intentionally acts with a purpose other than that of advancing the best interests of the corporation, where the fiduciary acts with the intent to violate applicable positive law, or where the fiduciary intentionally fails to act in the face of known duty to act, demonstrating a conscious disregard for his duties.[126]

In our hypothetical, the request by the Treasury fits squarely into the first of these categories of bad faith, though in the real world, the facts will rarely be so clear.

D. The Direct Challenge: The U.S. Treasury's Obligations as Controlling Shareholder

As this brief analysis of Delaware law suggests, a plaintiff could bring a plausible derivative suit alleging a breach of fiduciary duty against a private controlling shareholder in the facts set forth in the hypo, would stand an excellent chance of establishing that demand is excused, and would have a nontrivial chance of prevailing on the substantive claim.

How does this change now that the controlling shareholder is the government? The short answer: in more ways than you can begin to imagine! Below, we explore those differences. As we will explain, to sue the government, a private plaintiff would have to overcome the protections the government has granted itself under the heading of sovereign immunity and may not be able to proceed in the Delaware state court.[127] Before we pursue this analysis, however, we want to stress that even in the "ideal" scenario in which a plaintiff could go to a Delaware court that would apply ordinary Delaware law, a suit against the U.S. government as controlling shareholder faces special problems.

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125. 911 A.2d 362 (Del. 2006).

126. *Id.* at 369 (quoting *In re* Walt Disney Co., 906 A.2d 27, 67 (Del. 2006)).

127. For an excellent and comprehensive analysis of the substantive and procedural law governing claims against the federal government, see GREGORY C. SISK, LITIGATION WITH THE FEDERAL GOVERNMENT (4th ed. 2006). Much of the following discussion is indebted to Sisk's analysis.

1. Delaware Law and the U.S. Government.—Most lawsuits for breaches of fiduciary duty in a public Delaware corporation are brought in the Delaware Court of Chancery, a court that specializes in corporate law and has widely acknowledged expertise in dealing with such suits. But even apart from the jurisdictional problems addressed below, the Delaware Court of Chancery is less than the ideal venue for pursuing fiduciary-duty claims against the U.S. government. The state of Delaware derives substantial revenues from its franchise tax (paid mostly by public corporations). In 2010, Delaware received revenues of $633.1 million or about 20% of the state's budget.[128] Delaware is obviously keen on having these revenues flow into its coffers.

Delaware is able to charge corporations significant franchise fees because its corporate law and the quality of its judiciary are considered superior to the law and the judiciary of other states. However, as Mark Roe has forcefully pointed out, Delaware's franchise-tax business lives by the grace of the federal government.[129] Congress could, in one fell swoop, wipe out this business by federalizing corporate law. Congress, of course, has not done so and, as we have argued, is unlikely to do so under ordinary political circumstances.[130] This being said, Delaware clearly has an incentive to avoid annoying the U.S. government or even to avoid action that may annoy the U.S. government.

The members of Delaware's judiciary are usually former lawyers or government officials who are well aware of the state's interest. Thus, one may wonder whether the Delaware court, consciously or subconsciously, may deal with suits against the U.S. government for breaches of fiduciary duty less strictly than with equivalent suits against private parties. When the law or the facts are unclear, there will be an inherent temptation not to pick a fight with someone who can cut off so much of your funding. Accordingly, even if a plaintiff could bring a lawsuit against the U.S. government in the Delaware state court, she may be well-advised to seek a different forum.

In addition, Delaware doctrinal law is—at least at present—not well equipped to handle the kind of conflicts that would arise when the government is the controlling shareholder. This is illustrated by our hypothetical request to avoid factory closures in states that are politically important for the government, either because of public policy or partisan political

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128. DEL. DEP'T OF FIN., DELAWARE FISCAL NOTEBOOK 29 (2010), *available at* http://finance.delaware.gov/publications/fiscal_notebook_10/fiscal_notebook_10.pdf.

129. *See* Mark Roe, *Delaware's Competition*, 117 HARV. L. REV. 588, 600–07 (2004) (explaining that federal legislation could easily displace Delaware corporate law and that the mere fear of this possibility influences Delaware lawmakers to avoid provoking federal authorities).

130. *See* Marcel Kahan & Edward Rock, *Symbiotic Federalism and the Structure of Corporate Law*, 58 VAND. L. REV. 1573, 1576 (2005) ("We argue that the possibility of federal preemption constitutes a threat to Delaware, but this threat is significant only in times . . . when systemic change is seen as generating a significant populist payoff.").

considerations. When the government, as controlling shareholder, interferes in business decisions, many conflicts of interest will be based on political interests—such as in this hypothetical—rather than financial—such as in the hypothetical of the loan by DMAC.

But it is hard for judges, including Delaware's, to evaluate such political interference. Virtually any action taken by the government has some plausible political motive. How does a judge evaluate the materiality of conflicts when the conflict is nonfinancial? Should the judge determine the importance of the political motive on its own or in relation to nonpolitical motives? And important to whom? The Secretary of the Treasury, the President, or the President's chief pollster? What evidence can be adduced? Can all government officials be deposed and internal records be requested? It is clear that problems abound.

As a result, even if the government were treated doctrinally like any other controlling shareholder, governmental control of companies with minority shareholders would raise special problems. But as discussed below, the government is treated rather differently. This, alas, magnifies the problems. As we have argued elsewhere, because Delaware is bound to lose any confrontation with Washington, it is well-advised to avoid such fights, preferably through reliance on discretion within procedural rules rather than through a distortion of its corporate law doctrine.[131]

2. Sovereign Immunity and Its Limits: Claims Against the U.S. Government.—The starting point for any analysis involving suits against government entities is the doctrine of sovereign immunity, which holds that the U.S. government cannot be sued except insofar as it has waived its immunity.[132] Through various statutes, the U.S. government has waived much of its immunity, but not all, and always with limitations.

Moreover, because of the general immunity, any waivers are narrowly construed and burdened with conditions. The principal waivers of sovereign immunity are contained within the FTCA, which, broadly speaking, permits suits against the United States for tortious acts by its agents;[133] the Tucker Act, which permits claims against the United States for damages not involv-

131. *See* Kahan & Rock, *supra* note 63, at 756 (commenting favorably on Delaware Vice Chancellor Parsons's decision to allow a New York court to decide a question of Delaware law in order to avoid a dilemma that pitted state precedent against prudent public policy); Kahan & Rock, *supra* note 130, at 1621 ("If Delaware is not able to regulate certain conduct effectively, it is probably in its interest to have this conduct regulated on the federal level (or by other states) to fill the lacunae in its own law."); Kahan & Rock, *supra* note 111, at 410 (urging Delaware to "duck" confrontations with Washington and providing suggestions on how to do so).

132. *See* United States v. Sherwood, 312 U.S. 584, 586 (1941) ("The United States, as sovereign, is immune from suit save as it consents to be sued . . . ."); 14 CHARLES ALAN WRIGHT, ARTHUR R. MILLER & EDWARD H. COOPER, FEDERAL PRACTICE AND PROCEDURE § 3654 (3d ed. 1998) ("[T]he United States may not be sued without its consent.").

133. 28 U.S.C. § 2674 (2006).

ing tortious conduct (which includes, *inter alia*, contract claims and takings claims);[134] and the APA, which permits actions against the United States for review of agency action seeking relief other than money damages.[135] As we will discuss below, each of these frameworks complicates actions against the United States for acts that, under Delaware corporate law, could constitute breaches of the duty of loyalty or care.

a. Jurisdiction and Venue: The Limitation of Delaware's Role.—A key dimension of sovereign immunity that remains in force is choice of forum. The United States has never waived its immunity to suit in state court. Rather, under 28 U.S.C. § 1346, *all* suits against the United States must be brought either in federal district court or the Court of Federal Claims, depending on the cause of action. Under 28 U.S.C. § 1442, any claim against the United States filed in state court can be removed to federal district court. Once in the federal system, who, if anyone, *can* plaintiffs sue and for what? Here the real complexity begins. In the following subsections, we will analyze potential claims under the three principal statutory headings: the FTCA, the Tucker Act, and the APA.[136]

b. FTCA Claims.

i. Is a Breach of Fiduciary Duty a "Tort"?—The FTCA waives sovereign immunity for "tort claims." The key substantive provision is provided by 28 U.S.C. § 2674, which states that

> The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages.

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134. 28 U.S.C. § 1491 (2006).

135. 5 U.S.C. § 702 (2006).

136. These provisions cannot be avoided by suing government agents rather than the government. The *Ex parte Young*, 209 U.S. 123 (1908), fiction that a suit against a government agent is not a suit against the government was essentially eliminated by the provision for direct review of agency action under 5 U.S.C. § 702 (as we discuss further below). This is complemented by the Federal Employees Liability Reform and Tort Compensation Act, Pub. L. No. 100-694, 102 Stat. 4563 (1988), which provides that

> Upon certification by the Attorney General that the defendant employee was acting within the scope of his office or employment at the time of the incident out of which the claim arose, any civil action or proceeding commenced upon such claim in a State court shall be removed without bond at any time before trial by the Attorney General to the district court of the United States for the district and division embracing the place in which the action or proceeding is pending. Such action or proceeding shall be deemed to be an action or proceeding brought against the United States under the provisions of this title and all references thereto, and the United States shall be substituted as the party defendant. This certification of the Attorney General shall conclusively establish scope of office or employment for purposes of removal.

28 U.S.C. § 2679(d)(2). This Act is commonly known as the Westfall Act.

The key jurisdictional provision is provided by 28 U.S.C. § 1346(b)(1), which decrees exclusive federal jurisdiction. The first challenge, then, is determining whether breach-of-fiduciary-duty claims are "tort" claims.[137] This is a conceptually interesting and complex question that does not have a clear answer.

As a historical matter, breach of fiduciary duty is not a tort. It is an equitable rather than a legal claim and predates the sources of modern tort law, namely, trespass and trespass on the case.[138]

As a conceptual matter, it is also pretty clear that breaches of fiduciary duties are not torts, at least not in the common law use of that term, although they may be "civil wrongs."[139] Indeed, if one carefully distinguishes between fiduciary duties and the duties of fiduciaries, one can identify core duties created by the fiduciary relationship that are, in fact, separate and apart from duties created by tort or contract law. On the other hand, the conceptual argument may prove too much, at least for Delaware law: when one carefully defines fiduciary duty, many argue that the trustee's or fiduciary's duty of care is not, properly speaking, a *fiduciary* duty at all, although it may well be a duty that a fiduciary has.[140]

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137. Sovereign immunity to claims under the Securities Exchange Act has not been waived for two reasons. First, under § 3(c), the U.S. Treasury is exempt from liability under § 10(b). 15 U.S.C. § 78c(c) (2006). Second, the FTCA explicitly exempts claims of misrepresentation or deceit from the waiver of sovereign immunity. 28 U.S.C. § 2680(h). This includes both negligent and intentional misrepresentations, as well as omissions of material fact. McNeily v. United States, 6 F.3d 343, 347 (5th Cir. 1993).

138. *Cf.* Joshua Getzler, *Rumford Market and the Genesis of Fiduciary Obligation* (describing how fiduciary law was created in equity and stretches further back than originally expected and even precedes the law of trusteeship itself), *in* MAPPING THE LAW: ESSAYS IN MEMORY OF PETER BIRKS 577, 596–97 (Andrew Burrows & Alan Rodger eds., 2006).

139. *See, e.g.*, Peter Birks, *The Content of Fiduciary Obligation*, 34 ISR. L. REV. 3, 3 (2000) ("Fiduciary obligations form a sub-set of those primary obligations the breach of which constitutes a civil wrong."); P.D. Finn, *The Fiduciary Principle*, *in* EQUITY, FIDUCIARIES, AND TRUSTS 1, 24–25 (T.G. Youdan ed., 1989); Sarah Worthington, *Fiduciaries: When Is Self-Denial Obligatory?* 58 CAMBRIDGE L.J. 500, 503 (1999) ("In short, fiduciary terminology should be used carefully and restrictively, so that fiduciary law operates *only* to exact loyalty; it does not concern itself with matters of contract, tort, unjust enrichment and other equitable obligations (such as breach of confidence)."); *cf.* R.P. Austin, *Moulding the Content of Fiduciary Duties* ("The fiduciary duties relate to improper profits and the avoidance of conflicts of interest, and we should no longer use fiduciary terminology to describe other duties to which fiduciaries and others may be subject."), *in* A.J. OAKLEY, TRENDS IN CONTEMPORARY TRUST LAW 153, 156 (1996). Birks provides a different, although related, analysis of the content of the fiduciary obligation. For Birks, fiduciary duty is derivative from the duty of the trustee of an express trust. Birks, *supra*, at 3. By contrast, Getzler suggests that the evidence equally supports the view that fiduciary duty predates, and forms an essential component of, the creation of express trusts and the duties of the trustee. Getzler, *supra* note 138, at 577. For a U.S. perspective with U.S. citations, see Roy Ryden Anderson & Walter W. Steele, *Fiduciary Duty, Tort and Contract: A Primer on the Legal Malpractice Puzzle*, 47 S.M.U. L. REV. 235, 235 (1994).

140. *See, e.g.*, Birks, *supra* note 139, at 5 (discussing how imprecise definitions of fiduciary obligations could cause the law governing fiduciary obligations to "duplicat[e] the work of the

More recently, the issue of how to categorize a breach of fiduciary duty has arisen in connection with the question of whether a statute of limitations applies to breach-of-fiduciary-duty claims and, if so, which statute. Older cases held that statutes of limitations do not apply in equity, which instead relies on the more flexible doctrine of laches.[141] Over time, as the jurisdiction of equity courts has expanded, as in Delaware, this distinction has broken down. Under current Delaware law, the Delaware Court of Chancery looks to legal statutes of limitations as establishing a presumption for the application of laches to equitable claims,[142] although with a heavy dose of equity in its liberal rules for tolling.

This evolution has forced courts to reach the question of *which* statute of limitations to apply or look to for guidance. In some states, courts have applied the tort statute.[143] Other courts have applied the statute of limitations for contracts.[144] Finally, others, including Delaware, have applied a more general, catch-all limitation rule, even when a specific tort rule exists.[145] Statutes of limitations, then, provide an uncertain guide to whether breach-of-fiduciary-duty claims are tort claims.

But history, conceptual analysis, or analogous situations under state law cannot alone determine whether the use of the term *tort* in the FTCA was intended to include or should be read to include breaches of fiduciary duty. Rather, the question is whether the FTCA should, as a matter of statutory interpretation, be viewed as waiving immunity for breaches of fiduciary duty. This question is linked to whether breach-of-fiduciary-duty cases can be

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ordinary law of tort" and referencing the leading case, Bristol & West Bldg. Soc'y v. Motthew, [1996] Ch. 1 (Eng.), against such "indefensible duplication").

141. *See* Kahn v. Seaboard Corp., 625 A.2d 269, 271–75 (Del. Ch. 1993) (providing a very perceptive discussion of the older cases pertaining to this doctrine).

142. Albert v. Alex Brown Mgmt. Servs., No. Civ.A. 762-N, 2005 WL 1594085, at *12 (Del. Ch. Aug. 26, 2005); *see also Kahn*, 625 A.2d at 275. For a good discussion of the more general phenomenon, see Matthew G. Dore, *Statutes of Limitation and Corporate Fiduciary Duty Claims: A Search for Middle Ground on the Rules/Standards Continuum*, 63 BROOK. L. REV. 695, 720–41 (1997).

143. *See, e.g.*, FDIC v. Dawson, 4 F.3d 1303, 1310 (5th Cir. 1993) (addressing claims against the directors and officers of a failed bank that sounded in tort and were therefore governed by Texas's two-year statute of limitations); Crosby v. Beam, 615 N.E.2d 294, 299–300 (Ohio Ct. App. 1992) (holding that a minority stockholder's claims against corporate directors, officers, and the corporate entity were governed by Ohio's four-year tort statute of limitations).

144. *See, e.g.*, RTC v. Armbruster, 52 F.3d 748, 750 (8th Cir. 1995) (holding that claims against the directors of a failed savings and loan were governed by Arkansas's three-year limitations provision for contract actions); Bibo v. Jeffrey's Rest., 770 P.2d 290, 295 (Alaska 1989) (addressing claims, against corporate directors, that were governed by Alaska's six-year statute of limitations for contract actions).

145. *See, e.g.*, *Kahn*, 625 A.2d at 277 (applying a general three-year limitation period rather than the two-year period governing torts such as wrongful death, injury to personal property, and personal injuries). More recently, Travis Laster and Michelle Morris have argued persuasively that, at least in terms of Delaware's Uniform Contribution Among Tortfeasors Act, breaches of fiduciary duty should be treated as "equitable torts." *See* J. Travis Laster & Michelle D. Morris, *Breaches of Fiduciary Duty and the Delaware Uniform Contribution Act*, 11 DEL. L. REV. 71 (2010).

brought under the second major infringement on sovereign immunity, the Tucker Act, because the Tucker Act is explicitly complementary and nonoverlapping.[146] Unfortunately, the legislative history of the FTCA seems to be entirely silent on the question, focusing instead on whether the government should assume liability for automobile accidents: "With the expansion of governmental activities in recent years, it becomes especially important to grant to private individuals the right to sue the Government in respect to such torts as negligence in the operation of vehicles."[147]

The *Indian Trust* cases[148]—a line of cases that have been uniformly brought under the Tucker Act (which we will discuss later)—cast some light. In those cases, Native American tribes sued, alleging that the U.S. government had breached fiduciary duties owed to the Indian tribes in the stewardship of tribes' land and natural resources. Thus, for example, in *United States v. Mitchell* (*Mitchell II*),[149] members of the Quinault Tribe alleged that the U.S. government had breached its fiduciary duties to them by failing to manage their allotted lands properly, a claim the Supreme Court accepted.[150] If, under *Mitchell II*, a breach-of-fiduciary-duty claim can be brought under the Tucker Act, then it must be a claim for damages "not sounding in tort."[151]

Mitchell II, however, involved an explicit, federal statutory acceptance of a fiduciary relationship toward the tribe members. It may be that it was the presence of this specific statute rather than the general nature of the claim that brought it under the Tucker Act.[152] Indeed, there is some Tucker Act law that narrowly construes the *Indian Trust* cases and holds that generally claims of breaches of fiduciary duty, if they give rise to any claim, give rise to torts.[153] Along these same lines, the Delaware Court of Chancery, interpreting and applying a Massachusetts statute that limited the liability of charities in tort actions, held that (at least under Massachusetts law) breach of

146. *See* 28 U.S.C. § 1491(a)(1) (2006) ("The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States . . . for liquidated or unliquidated damages in cases *not sounding in tort*." (emphasis added)).

147. H.R. REP. NO. 77-2245, at 7 (1942).

148. *See infra* subsection III(D)(2)(c).

149. 463 U.S. 206 (1983).

150. *Id.* at 210–11.

151. *Id.* at 212.

152. Of course, that a state common-law-based breach-of-fiduciary-duty claim cannot be brought under the Tucker Act does not mean that it can be brought under the FTCA. It could fall between two stools, always a possibility given the background of sovereign immunity and the narrow interpretation of any derogations. *See, e.g.*, Kashin v. Kent, 457 F.3d 1033, 1037, 1044 (9th Cir. 2006) (holding that a tort action against a federal employee involved in a car accident in Russia was barred by the FTCA's foreign-country exception).

153. *See* Am. Ins. Co. v. United States, 62 Fed. Cl. 151, 158 (2004) ("For one thing, such general breaches of claimed fiduciary or equitable duties are ordinarily viewed as giving rise, if anything, to torts, the subject matter of which plainly is outside this court's jurisdiction.").

fiduciary duty could be considered a tort for the purposes of the statute.[154] The question of how breach-of-fiduciary-duty actions fit within the federal waivers of sovereign immunity is thus uncertain.

But suppose, arguendo, that a breach of the duty of loyalty will be viewed as a tort for the purposes of the FTCA. Which state's fiduciary law would apply? Suppose that the plaintiff alleges that the responsible Treasury officials breached their fiduciary duties while in Detroit for a board meeting. According to § 1346(b)(1), whether the act or omission is a tort is determined by whether "a private person[] would be liable to the claimant in accordance with the law of the place where the act or omission occurred."[155] This provision points to Michigan as the relevant state. But, as a leading Supreme Court case points out, in determining the relevant law for the FTCA, you take into account the whole law of the state, including its choice-of-law rules.[156] Because Michigan, like most states, follows the "place of incorporation" doctrine in determining applicable corporate law[157] and because DM and DMAC are both, by hypothesis, Delaware corporations, Delaware law would provide the rule of decision.

ii. The "discretionary function" exception.—But a plaintiff is hardly home free. Under § 2680(a), the FTCA does not apply to "[a]ny claim . . . based upon the exercise or performance or the failure to exercise or perform a discretionary function or duty on the part of a federal agency or an employee of the Government, whether or not the discretion involved be abused."[158] This defense, known as the "discretionary function exception," provides a very important limitation on the reach of the FTCA. Indeed, depending on how broadly it is interpreted, the exception could swallow the whole waiver of sovereign immunity.

Assuming, as we do above, that the Treasury officials who make the decision to compel DMAC to lend to DM and its customers and dealers on preferential terms are employees (whether or not they are also directors), does the discretionary function exception apply?

There is a fairly long line of Supreme Court cases interpreting this language in an attempt to draw a line between protecting public officials' policy choices that have winners and losers, without also immunizing negligent conduct that injures innocent bystanders. Thus, in *Dalehite v. United States*,[159] at issue was a conscious decision to cut corners in order to reduce

154. Oliver v. Boston Univ., C.A. No. 16570-NC, 2005 Del. Ch. LEXIS 14, at *9–11 (Del. Ch. Jan. 28, 2005).

155. 28 U.S.C. § 1346(b)(1) (2006).

156. Richards v. United States, 369 U.S. 1, 11 (1962).

157. RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 306, 309 (1971).

158. 28 U.S.C. § 2680(a).

159. 346 U.S. 15 (1953).

costs in the manufacture of fertilizer to be shipped abroad, a decision that resulted in a cargo ship exploding in the harbor and causing damage.[160] In holding that the decision was protected by the discretionary function exception, the Court drew a distinction between the "planning level," which was protected by the exception, and the "operational level," which was not.[161] Later, in *United States v. Varig Airlines*,[162] the Court rejected an FTCA claim for negligent certification of an aircraft and added that the purpose of the exception was to protect the government from judicial second-guessing of legislative and administrative decisions that were grounded in economic and political policy.[163] Even later, in *Berkovitz v. United States*,[164] the Court examined a claim that the FDA had negligently licensed a vaccine manufacturer and negligently approved the release of a particular batch of vaccine.[165] The Court limited the exception to "discretionary" decisions—where the decision involved was a matter of permissible choice for a government employee—and refused to apply it to mandatory decisions that must be made on the basis of objective criteria when there is no permissible discretion.[166]

The Court once again tried to define the limits of the exception in its most recent effort, *United States v. Gaubert*,[167] which emerged out of the Savings and Loan Crisis of the 1980s. In *Gaubert*, the founder and largest shareholder of a savings and loan accused the Federal Home Loan Bank Board (FHLBB) (the now-superseded agency then charged with regulating savings and loan associations) of negligence in its supervision of the savings and loan. According to the shareholder, the FHLBB interfered in day-to-day operations of the savings and loan, pressured the savings and loan to merge, threatened to close it unless the managers and board resigned, influenced the selection of new management, and ultimately caused the savings and loan to fail.

The Supreme Court rejected the claims and stated that "when established governmental policy, as expressed or implied by statute, regulation, or agency guidelines, allows a Government agent to exercise discretion, it must be presumed that the agent's acts are grounded in policy when exercising that discretion."[168]

The *Gaubert* standard—criticized in the literature as too deferential in creating a perhaps irrebuttable presumption that discretion was exercised

160. *Id.* at 22–23.
161. *Id.* at 42.
162. 467 U.S. 797 (1984).
163. *Id.* at 814.
164. 486 U.S. 531 (1988).
165. *Id.*
166. *Id.* at 535–37.
167. 499 U.S. 315 (1991).
168. *Id.* at 324.

when the decision was of a *type* that is susceptible to policy analysis, even when there is no evidence that the agent actually engaged in any such analysis[169]—provides the current boundaries of the exception. Interestingly, for our purposes, it does so in a context that is at least superficially quite similar to the current state of affairs—efforts by government officials to work through a banking crisis.

With respect to the duty-of-care claim, *Gaubert* would seem to provide a very strong defense. In *Gaubert*, a founder and large shareholder of a savings and loan alleged that the FHLBB's day-to-day second-guessing and interference caused the savings and loan to fail. Nonetheless, the court held that the FHLBB was protected under the discretionary function exception.[170] Here, as there, one could argue, the exception would apply because, as *Gaubert* held, "it must be presumed that the agent's acts are grounded in policy when exercising that discretion."[171] The decision to adopt a greener product mix is surely no less entitled to the discretionary function exception than interfering in the day-to-day operation of a savings and loan.

On the other hand, *Gaubert* involved a governmental agency that used its discretion in the exercise of its regulatory function. Whether the rationale of *Gaubert* and the other cases applies with equal force to governmental officials who act outside their regulatory purview—say Treasury officials with respect to the type of car to be produced and the location of factories to be closed—is unclear.

iii. Are the actions in the hypo choices from "a range of permissible courses"?—The duty-of-loyalty claim is more complicated. Were the actions of the Treasury officials, in leaning on DMAC to lend to DM, its dealers, and its customers, pursuant to a regulation that allowed the exercise of discretion and policy judgment by the employee or agent? How do the agents' actions compare to those of the FHLBB in overseeing the failing savings and loan? According to the *Gaubert* court, "day-to-day management of banking affairs, like the management of other businesses, regularly requires judgment as to which of a range of permissible courses is the wisest. Discretionary conduct is not confined to the policy or planning level."[172]

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169. *See, e.g.*, Harold J. Krent, *Preserving Discretion Without Sacrificing Deterrence: Federal Governmental Liability in Tort*, 38 UCLA L. REV. 871, 898 n.117 (1991) (arguing that the *Gaubert* standard "provides an insufficient limiting principle" because nearly any action can somehow be shown to be tied to a policy motivation); Peter H. Schuck & James J. Park, *The Discretionary Function Exception in the Second Circuit*, 20 QUINNIPIAC L. REV. 55, 65–66 (2000) (illustrating how even the most routine actions can be grounded in general policy concerns).

170. *Gaubert*, 499 U.S. at 326.

171. *Id.* at 324.

172. *Id.* at 325.

In our hypo, did the Treasury agents exercise judgment in choosing the wisest of a range of *permissible* options? Here, we get to a very interesting feature of the government's involvement in the automobile industry. From a legal and regulatory perspective, that involvement has been ad hoc, even perhaps haphazard. As a result, the relevant statutory authority provides unclear guidance on what courses of action are permissible.

When the EESA was enacted in October 2008, Congress was led to believe that the $700 billion would be used to buy up toxic assets, thereby freeing banks to lend again. The original conception for the TARP program and the basis upon which it was presented to Congress[173] was to give the Treasury authority and funding to purchase illiquid assets from troubled financial institutions.

As noted above, the operative provisions of the statute reflect this understanding. There is plenty of legislative history that is consistent with this reading. Even worse, prior to launching the AIFP, the Treasury sought congressional approval of an automobile bailout and was sharply rebuffed.[174] As George Will has argued, in November 2008, Paulson specifically told a House committee, "'I've said to you very clearly that I believe that the auto companies fall outside of [TARP's] purpose.' Then advocates of a Detroit bailout proposed legislation to authorize that. It failed."[175]

As Will pointed out, and as the objectors in the Chrysler bailout argued,[176] the creation of the AIFP to bail out car companies does not find much of a basis in the statute. One can credibly argue that purchasing equity securities is permitted under the EESA, even though the original plan was to purchase asset-backed securities clogging up the banks' balance sheets. As discussed above, the statutory definition of troubled assets is quite broad, and equity securities could well be a "financial instrument that the Secretary, after consultation with the Chairman of the Board of Governors of the Federal Reserve System, determines the purchase of which is necessary to promote financial market stability."[177] But this power is limited to purchasing troubled assets from "financial institutions," and it takes extraordinarily creative statutory interpretation to find that automobile companies are finan-

173. According to Sorkin, by the time that Congress approved the EESA, the Treasury had already decided to shift the focus to direct investments in troubled financial institutions. SORKIN, *supra* note 69, at 508–16.

174. David Herszenhorn, *Chances Dwindle on Bailout Plan for Automakers*, N.Y. TIMES, Nov. 13, 2008, at A1.

175. George F. Will, *More Judicial Activism, Please*, WASH. POST, June 14, 2009, at A15 (alteration in original).

176. *See, e.g.*, Corrected Objection of Ind. Pensioners to Debtor's Motion for an Order at 17–27, *In re* Chrysler, LLC, No. 09-50002 (AJG), (Bankr. S.D.N.Y. May 19, 2009).

177. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, § 3(9)(B), 122 Stat. 3765, 3767 (to be codified at 12 U.S.C. § 5202(9)(B)).

cial institutions lurking in the phrase "included but not limited to," however troubled they may be.

Not surprisingly, given the uncertain (or perhaps absent) statutory basis for the use of TARP funds for auto-company bailouts, EESA does not provide the same sort of comprehensive regulatory structure for the resolution or conservation of troubled automobile companies that is provided to bank regulators under the Federal Deposit Insurance Act or the parallel statutes governing other banking agencies. Given this lack, can the Treasury agents who decided to use DMAC funds to help out DM find protection in the discretionary function exception? In the words of *Gaubert*, do the operative provisions of EESA provide agents of the Treasury with the sort of discretion that "regularly requires judgment as to which of a range of permissible courses is the wisest"?[178]

As before, one can argue it either way. On the one hand, because the Congress that enacted the EESA never thought that the money would be used to buy controlling equity stakes in private companies—neither controlling stakes in financial institutions such as AIG or GMAC nor controlling positions in automobile companies like GM—there is nothing in EESA that addresses how the Treasury is to manage its equity portfolio. The closest that the EESA comes to a provision providing guidance is § 106, "Rights; Management; Sale of Troubled Assets; Revenues and Sale Proceeds":

> (a) EXERCISE OF RIGHTS.—The Secretary may, at any time, exercise any rights received in connection with troubled assets purchased under this Act.
>
> (b) MANAGEMENT OF TROUBLED ASSETS.—The Secretary shall have authority to manage troubled assets purchased under this Act, including revenues and portfolio risks therefrom.[179]

But, while § 106 authorizes the Secretary to manage the assets, it does not address *how* the Secretary is to address relations among portfolio companies and thus arguably does not provide guidance, even general guidance, to a Treasury agent in exercising discretion to achieve the goals.

On the other hand, EESA does address conflicts of interest. Section 108, "Conflicts of Interest," provides,

> (a) STANDARDS REQUIRED.—The Secretary shall issue regulations or guidelines necessary to address and manage or to prohibit conflicts of interest that may arise in connection with the administration and execution of the authorities provided under this Act, including—
>
> > (1) conflicts arising in the selection or hiring of contractors or advisors, including asset managers;

178. United States v. Gaubert, 499 U.S. 315, 325 (1991).

179. EESA § 106(a)–(b), 122 Stat. at 3773 (to be codified at 12 U.S.C. § 5216(a)–(b)).

> (2) the purchase of troubled assets;
>
> (3) the management of the troubled assets held;
>
> (4) post-employment restrictions on employees; and
>
> (5) any other potential conflict of interest, as the Secretary deems necessary or appropriate in the public interest.
>
> (b) TIMING.—Regulations or guidelines required by this section shall be issued as soon as practicable after the date of enactment of this Act.[180]

On January 21, 2009, the Treasury issued an "interim rule" that addresses "conflicts that may arise during the selection of individuals or entities seeking a contract or financial agency agreement with the Treasury (retained entities), particularly those involved in the acquisition, valuation, management, and disposition of troubled assets."[181] In particular, the interim rules deal with conflicts of interest that individuals and firms who have been retained by the Treasury may face. These rules are reasonably detailed and provide a fairly comprehensive structure for existing and future conflicts of interest faced by individuals or firms retained by the Treasury to work on TARP matters and impose a variety of restrictions on working for other firms with conflicting interests and on the use of confidential information. By contrast, there is nothing at all in the interim rules that relates to the Treasury's own potential conflicts of interest with respect to portfolio companies.

On the other hand, TARP is a work in progress and this lacuna could be remedied easily enough. Suppose additional rules were issued by the Secretary pursuant to EESA § 108 that granted Treasury agents managing TARP assets the same flexibility and open-ended discretion as provided for in the AIG Trust Agreement:

> [I]t is the FRBNY's view that (x) maximizing the Company's ability to honor its commitments to, and repay all amounts owed to, the FRBNY or the Treasury Department and (y) the Company being managed in a manner that will not disrupt financial market conditions, are both consistent with maximizing the value of the Trust Stock.[182]

Assume, additionally, that the rules set the same standard of care, according to which the agent must "(i) act[] in good faith in a manner the [agent] reasonably believed to be . . . in or not opposed to the best interests of the Treasury and (ii) ha[ve] no reasonable cause to believe his or her conduct [is] unlawful."[183]

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180. *Id.* § 108, 122 Stat. at 3774 (to be codified at 12 U.S.C. § 5218).

181. TARP Conflicts of Interest, 74 Fed. Reg. 3,431, 3,431 (Jan. 21, 2009) (to be codified at 31 C.F.R. pt. 31). To date, the "interim rules" have not been updated or made "final."

182. AIG Credit Facility Trust Agreement § 2.04 (Jan. 16, 2009), *available at* http://www.ny.frb.org/newsevents/news/markets/2009/AIGCFTAgreement.pdf.

183. *Id.* § 3.03.

Interestingly, of course, while these provisions would fill out the duties of the Treasury agents managing the Treasury portfolio, they do not provide clear guidance in our situation. In particular, if using power over DMAC to benefit DM clearly violates the controlling shareholder's fiduciary duties under Delaware law, is the conduct "unlawful"? And, if it is unlawful, does it fall outside the stipulated standard of care? And, finally, if it falls outside the standard of care imposed on the Treasury agents, are the agents still entitled to the discretionary function exception?

Consider one final variation. Suppose that the Treasury rules were to state straightforwardly that Treasury agents, in managing the Treasury's equity portfolio, are to respect the principles of corporate law and governance and to act with due care and loyalty. Interestingly, if these were the marching orders, the defense under the discretionary function exception would be very strong. After all, the implementation of the duties of care and loyalty under Delaware law is rife with discretion and fact-specific determinations. The entire-fairness test is an ex post standard as opposed to an ex ante rule. In its various formulations, it sets a broad standard (fairness of price and fairness of process), allocates burdens, and examines specific transactions.

After working through the considerable complexity involved in challenging the Treasury's hypothetical conduct under the FTCA, only two things are clear. First, even with regard to a fairly clear violation of the duty of loyalty or care, success is hardly assured. One can imagine a court coming out either way. Second, given the procedural and substantive complexities described above, one can hardly expect that an FTCA suit will provide the first line of defense against problematic conduct. Put somewhat differently, if we are concerned that the government, using its controlling stake, will take actions driven by policy objectives that are not in the interests of the portfolio company, we probably should not depend on a breach-of-fiduciary-duty action under the FTCA to protect against this possibility.

c. Potential Tucker Act Fiduciary-Duty Claims.—We now turn to the Tucker Act, the second main waiver of sovereign immunity. Specifically, § 1491(a) provides,

> The United States Court of Federal Claims shall have jurisdiction to render judgment upon any claim against the United States founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, or for liquidated or unliquidated damages in cases not sounding in tort.[184]

184. 28 U.S.C. § 1491(a) (2006).

If a breach of fiduciary duty is not a tort for the purposes of the FTCA, can an action be brought under the Tucker Act in the United States Court of Federal Claims on the grounds that it is a claim for "liquidated or unliquidated damages in cases not sounding in tort"?[185]

Returning to the *Indian Trust* cases, we find the closest and most intriguing analogy. Since the early 1980s, the Supreme Court has decided a number of cases in which Native American tribes have sued the United States for damages for improper management of tribal property including timber lands and coal resources. In the leading case of *Mitchell II*, the Court traced the history of the U.S. role as custodian of tribal lands back into the 19th century, finding that the relationship was not merely a "naked trust" established by the Allotment Act of 1887 to prevent alienation and did not impose fiduciary duties, as was held in *Mitchell I*,[186] but rather through a variety of subsequent statutes and regulations, established comprehensive federal control over the Native American lands.[187] With this comprehensive control, the Court held, came fiduciary duties, duties that had been breached in the mismanagement of the timber resources.[188] Similarly, when, pursuant to statute, the United States took full control of Fort Apache, used the Fort for the government's own purposes, and neglected it, the Court held that, in doing so, the United States took on a trustee's duty to preserve and maintain the trust corpus, a duty that it had breached.[189]

But the Navajo coal-leasing cases make clear that the level of government involvement must be comprehensive. In the first *Navajo Nation* case,[190] the Supreme Court held that the Secretary of the Interior's obligation to approve mineral leases did *not* impose fiduciary duties in doing so, at least when the tribe and the coal company had negotiated terms.[191] When the *Navajo Nation* case returned to the Supreme Court after remand, the Court was even sharper in rejecting the claim:

> The Federal Government's liability cannot be premised on control alone. The text of the Indian Tucker Act makes clear that only claims

185. Although we often think of the corporation as a nexus of contracting and of fiduciary duties through a contractual framework, this is not a sufficient basis to claim that a breach-of-fiduciary-duty claim is a breach of an implicit contract. Under the Tucker Act, "implicit contracts" refers to "implied in fact" contracts (i.e., actual contracts implied from the conduct of the parties in light of the circumstances surrounding their interaction) and not "implied in law" contracts. United States v. Mitchell (*Mitchell II*), 463 U.S. 206, 218 (1983). Because it is difficult if not impossible to conceptualize this case as a breach-of-contract action, the scope of *United States v. Winstar*, 518 U.S. 839, 909 (1996), and its implications for the limits of sovereign immunity under the Tucker Act, do not arise.

186. United States v. Mitchell (*Mitchell I*), 445 U.S. 535, 542 (1980).

187. *Mitchell II*, 463 U.S. at 228.

188. *Id.* at 211.

189. United States v. White Mountain Apache Tribe, 537 U.S. 465, 471 (2003).

190. United States v. Navajo Nation (*Navajo Nation I*), 537 U.S. 488 (2003).

191. *Id.* at 506–08.

> arising under "the Constitution, laws or treaties of the United States, or Executive orders of the President" are cognizable (unless the claim could be brought by a non-Indian plaintiff under the ordinary Tucker Act). . . . In *Navajo I* we reiterated that the analysis must begin with "specific rights-creating or duty-imposing statutory or regulatory prescriptions." . . . *If* a plaintiff identifies such a prescription, and *if* that prescription bears the hallmarks of a "conventional fiduciary relationship," . . . *then* trust principles (including any such principles premised on "control") could play a role in "inferring that the trust obligation [is] enforceable by damages" . . . . But that must be the second step of the analysis, not (as the Federal Circuit made it) the starting point.[192]

Thus, though under the *Indian Trust* cases the United States can become a fiduciary and damages can be awarded for breaches of that duty, there is a high bar.

Does exercising control through the power conveyed by a controlling equity stake cause the United States to take on the fiduciary duties of a controlling shareholder, as under Delaware law? The law is not clear. *Navajo Nation II*, quoted above, holds that control alone is not enough. Rather, the Supreme Court has repeatedly emphasized that the duty must be based in the Constitution or a statutory enactment. As the court held in *Mitchell II*, and subsequently reiterated in *Navajo Nation II*, quoted above:

> [T]he Tucker Act "'does not create any substantive right enforceable against the United States for money damages.'" . . . A substantive right must be found in some other source of law, such as "the Constitution, or any Act of Congress, or any regulation of an executive department." . . . Not every claim invoking the Constitution, a federal statute, or a regulation is cognizable under the Tucker Act. The claim must be one for money damages against the United States, . . . and the claimant must demonstrate that the source of substantive law he relies upon "'can fairly be interpreted as mandating compensation by the Federal Government for the damage sustained.'"[193]

In our hypo, there is hardly the same sort of comprehensive statutory framework present in *Mitchell II*. Indeed, the only statutory basis seems to be the EESA, which provided the Treasury with authority to buy troubled assets in financial institutions. Moreover, *Mitchell II* seems to suggest that the basis must be either the U.S. Constitution or a *federal* statute: because it is a waiver of federal sovereign immunity that is at stake, state statutes or

192. United States v. Navajo Nation (*Navajo Nation II*), 129 S. Ct. 1547, 1558 (2009) (citations omitted).

193. *Mitchell II*, 463 U.S. at 216–17 (citations omitted).

common law are an insufficient basis.[194] The Treasury might therefore avoid *Mitchell II* and *White Mountain Apache Tribe* on the grounds that there is no adequate federal statutory basis on which to ground a claimed fiduciary duty.

But that may be too quick. The *Indian Trust* cases interpret the part of the Tucker Act that is explicitly limited to claims founded "upon the Constitution, or any Act of Congress or any regulation of an executive department."[195] But the (regular) Tucker Act also waives immunity with respect to any claim "founded either upon the Constitution, or any Act of Congress or any regulation of an executive department, or upon any express or implied contract with the United States, *or for liquidated or unliquidated damages in cases not sounding in tort.*"[196] Can one argue that, under that final clause, the acquisition of shares of a Delaware corporation gives rise to liability for damages because, in acquiring shares, the United States acquires control by virtue of the network of statutory and common law provisions that are Delaware corporate law (e.g., the right to elect directors under sections 212, 216, etc.), power that brings with it fiduciary duties? One might argue that this situation is much closer to *Mitchell II* and *White Mountain Apache Tribe*, in which the Supreme Court suggested that governmental fiduciary duties can arise when the government assumes control over property belonging to Indians. Thus, in *Mitchell II*, the Court stated,

> Moreover, a fiduciary relationship necessarily arises when the Government assumes such elaborate control over forests and property belonging to Indians. All of the necessary elements of a common-law trust are present: a trustee (the United States), a beneficiary (the Indian allottees), and a trust corpus (Indian timber, lands, and funds). "[W]here the Federal Government takes on or has control or supervision over tribal monies or properties, the fiduciary relationship normally exists with respect to such monies or properties (unless Congress has provided otherwise) even though nothing is said expressly in the authorizing or underlying statute (or other fundamental document) about a trust fund, or a trust or fiduciary connection."[197]

Later, in *White Mountain Apache Tribe*, the Court sounded the same themes, allowing actual control to substitute for absent statutory language:

> As to the property subject to the Government's actual use, then, the United States has not merely exercised daily supervision but has enjoyed daily occupation, and so has obtained control at least as

194. *See id.* at 216–18 (referring exclusively to Tucker Act claims against the United States "founded either upon the Constitution, or any Act of Congress, or any regulation of an executive department").

195. 28 U.S.C. § 1491(a)(1) (2006); *see also, e.g.*, *Mitchell II*, 463 U.S. at 216–18.

196. 28 U.S.C. § 1491(a)(1) (emphasis added).

197. *Mitchell II*, 463 U.S. at 225 (alteration in original) (citation and footnote omitted).

> plenary as its authority over the timber in *Mitchell II*. While it is true that the 1960 Act does not, like the statutes cited in that case, expressly subject the Government to duties of management and conservation, the fact that the property occupied by the United States is expressly subject to a trust supports a fair inference that an obligation to preserve the property improvements was incumbent on the United States as trustee. This is so because elementary trust law, after all, confirms the commonsense assumption that a fiduciary actually administering trust property may not allow it to fall into ruin on his watch. "One of the fundamental common-law duties of a trustee is to preserve and maintain trust assets." . . . Given this duty on the part of the trustee to preserve corpus, "it naturally follows that the Government should be liable in damages for the breach of its fiduciary duties."[198]

In *Navajo Nation II*, the Supreme Court distinguished *Mitchell II*, without overruling it, on the grounds that in *Mitchell II*, there was

> a series of statutes and regulations that gave the Federal Government "full responsibility to manage Indian resources and land for the benefit of the Indians." . . . Title 25 U.S.C. § 406(a) permitted Indians to sell timber with the consent of the Secretary of the Interior, but directed the Secretary to base his decisions on "a consideration of the needs and best interests of the Indian owner and his heirs" and enumerated specific factors to guide that decisionmaking. We understood that statute—in combination with several other provisions and the applicable regulations—to create a fiduciary duty with respect to Indian timber.[199]

Although one clearly cannot argue that there is a similarly comprehensive web of federal statutes that creates obligations on the federal government, one might argue that when the Treasury took a controlling interest in DMAC pursuant to authority granted by the EESA and then exercised that control pursuant to the General Corporation Law of Delaware to benefit another firm in its portfolio at the expense of DMAC, it took on the fiduciary duties of a controlling shareholder under Delaware law, and "it naturally follows that the Government should be liable in damages for the breach of its fiduciary duties."[200] Indeed, while the case law seems clear that the common law of trusts (or of fiduciary duties) will not be sufficient to ground the Treasury's obligation, the common law could be used to fill out the details of that obligation, especially, as here, when fiduciary duties are an

198. United States v. White Mountain Apache Tribe, 537 U.S. 465, 475–76 (2003) (citations omitted).

199. United States v. Navajo Nation (*Navajo Nation II*), 129 S. Ct. 1547, 1553–54 (2009) (citations omitted).

200. *Mitchell II*, 463 U.S. at 226.

intrinsic part of the (nonfederal) statutory framework that creates the governmental power at issue.

Although this seems to be a promising direction, such a claim would clearly be a step beyond current case law even if not precluded by the current Supreme Court jurisprudence. It is, of course, unclear whether a federal court would choose to take that step, or whether if it did, it would be affirmed on appeal. More to the point, fiduciary-duty law hardly provides any sort of robust protection that could plausibly substitute for Delaware's fiduciary-duty jurisprudence. Again, we are driven to the view that if we are concerned about the government's use of its controlling position, the Tucker Act theories are hardly reassuring.[201]

d. Claims Under the APA.—A third basis for challenging the Treasury's actions at DMAC is the APA. Section 702 of the APA explicitly waives sovereign immunity for actions against the United States so long as those actions do not seek money damages:[202]

> A person suffering legal wrong because of agency action, or adversely affected or aggrieved by agency action within the meaning of a relevant statute, is entitled to judicial review thereof. An action in a court of the United States seeking relief other than money damages and stating a claim that an agency or an officer or employee thereof acted or failed to act in an official capacity or under color of legal authority shall not be dismissed nor relief therein be denied on the ground that it is against the United States or that the United States is an indispensable party. The United States may be named as a defendant in any such action, and a judgment or decree may be entered against the United States . . . .[203]

Under the APA,[204] actions can be brought in federal district court against the United States to

> hold unlawful and set aside agency action, findings, and conclusions found to be—

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201. The Tucker Act also provides a cause of action to challenge a taking in violation of the Fifth Amendment. Although the opening hypothetical does not present a takings claim, with a little creativity one could add one (e.g., the Treasury decides to freeze out minority shareholders without compensation). While a takings claim could be a basis for challenging such an action, it does not provide a regulatory structure that parallels Delaware's fiduciary-duty law. For a brief summary of the applicable law, see SISK, *supra* note 127, § 4.09(b).

202. *Bowen v. Massachusetts*, 487 U.S. 879 (1988), blurred this line, but even under *Bowen*, damages for breach of fiduciary duty would be excluded. *Id.* at 899–900.

203. 5 U.S.C. § 702 (2006).

204. Although codified in the APA, this waiver applies more broadly and includes actions to enjoin violations of constitutional rights. In our case, because the Tucker Act permits actions for damages when takings without compensation are involved, this aspect of § 702 is marginal to our purposes.

> (A) arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with law;
>
> (B) contrary to constitutional right, power, privilege, or immunity;
>
> (C) in excess of statutory jurisdiction, authority, or limitations, or short of statutory right;
>
> (D) without observance of procedure required by law;
>
> (E) unsupported by substantial evidence in a case subject to sections 556 and 557 of this title or otherwise reviewed on the record of an agency hearing provided by statute; or
>
> (F) unwarranted by the facts to the extent that the facts are subject to trial de novo by the reviewing court.[205]

The question, then, is whether our plaintiff, a minority shareholder in DMAC, can bring an action under § 706 to enjoin the decision that requires DMAC to provide financing to GM and its dealers and its customers on preferential terms.

Fitting the hypo into administrative law categories is not easy. Consider, first, a conceptually easier issue that arises out of the Treasury's decision to invest TARP funds in Chrysler and GM. As noted above, these investments raise two questions. First, does a troubled auto company fall within the statutory definition of a "financial institution"? Second, does equity in new GM or new Chrysler fall within the definition of "troubled asset"? Both of these are questions of statutory interpretation and fit comfortably within the basic framework of administrative law.[206] Under *Chevron*,[207] the Treasury could certainly argue that Congress did not address the precise question at issue in the EESA, and, in any event, any congressional intent was certainly not unambiguously clear.[208] Given this and moving on to the classic second step of *Chevron*,[209] the Treasury might argue that its interpretations of the definitions of "troubled asset" and "financial institution" were both "permissible" ones and thus deserve deference.

But now contrast these typical questions of administrative law with our hypo in which the Treasury leans on DMAC to help DM. Note, first, that the

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205. 5 U.S.C. § 706.

206. I leave to the side the question of who would have standing. In the Chrysler bankruptcy proceeding, the Southern District of New York Bankruptcy Court held that secured-debt holders did not have standing to challenge the investment because they benefited from it. *In re* Chrysler LLC, 405 B.R. 79, 83 (Bankr. S.D.N.Y. 2009).

207. Chevron U.S.A., Inc. v. Natural Res. Def. Council, Inc., 467 U.S. 837 (1984).

208. *See id.* at 842–43 ("First, always, is the question whether Congress has directly spoken to the precise question at issue. If the intent of Congress is clear, that is the end of the matter; for the court, as well as the agency, must give effect to the unambiguously expressed intent of Congress.").

209. *See id.* at 843 ("[I]f the statute is silent or ambiguous with respect to the specific issue, the question for the court is whether the agency's answer is based on a permissible construction of the statute.").

action at issue is a rather different action than the decision to invest TARP funds in GM or Chrysler: it is not a normal exercise of agency authority. The Treasury is acting in the private sector, not in government forums, and using its shareholding to do so. It is not promulgating rules, nor distributing public funds, nor adjudicating matters.

Consider whether *Chevron* deference will apply. Here, the governing statute—in this case the EESA—offers no guidance for how the Treasury is to manage the portfolio. Although the EESA is clear that the Treasury has power to manage the portfolio—and so managing it is hardly ultra vires—it provides no guidance, no standards, no criteria, and only the most general goals:

> SEC. 2. PURPOSES.
>
> The purposes of this Act are—
>
> (1) to immediately provide authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States; and
>
> (2) to ensure that such authority and such facilities are used in a manner that—
>
> (A) protects home values, college funds, retirement accounts, and life savings;
>
> (B) preserves home ownership and promotes jobs and economic growth;
>
> (C) maximizes overall returns to the taxpayers of the United States; and
>
> (D) provides public accountability for the exercise of such authority.[210]

Moreover, although the EESA grants the Treasury the authority to exercise any rights associated with acquired assets and to manage the portfolio,[211] no guidance is provided beyond the General Purpose Clause with regard to how and for what purpose. And this is hardly accidental: it is crystal clear that when the EESA was debated and eventually enacted, Congress was not thinking about direct investments in equity, much less direct and controlling equity investments in auto companies.

Further, in managing the assets, the Treasury has not explicitly interpreted the EESA or any other statute, so there is no agency interpretation of its own statute to which *Chevron* deference could apply. While one could argue with regard to the investments in GM and Chrysler themselves that the Treasury's act of investing can be understood to be an implicit interpretation of the statutory definitions, that same argument is much harder to make with

210. Emergency Economic Stabilization Act (EESA) of 2008, Pub. L. No. 110-343, § 2, 122 Stat. 3765, 3766 (to be codified at 12 U.S.C. § 5201).

211. *Id.* § 106, 122 Stat. at 3773 (to be codified at 12 U.S.C. § 5216).

regard to the hypo because there is so little in the statute that pertains to the management of equity investments.

Considered as a policy judgment, would the Treasury's decision to lean on DMAC to help DM be invalid as "arbitrary, capricious, an abuse of discretion, or otherwise not in accordance with the law" in violation of § 706(2)(A)?[212] To the extent that this is another way of saying that agency action must be "reasonable," it begs the question of the relevant standard of reasonableness. Likewise, the final phrase—"or otherwise not in accordance with the law"—is suggestive without being clear on which laws it refers to.

The hypo arises because the federal government acts in the private setting without explicitly taking on the obligations of that position (which would incorporate Delaware law norms) or explicitly opting out through preemptive legislation. One approach to applying § 706 in this context would be to argue that, in corporate law as elsewhere, state law applies unless legitimately preempted by federal law, and thus, the Treasury is bound by the same state law limits as any other controlling shareholder. To the extent, then, that the Treasury's actions are inconsistent with Delaware corporate law—as they clearly would be—they are "not in accordance with law" and thus invalid under § 706.

The counterargument, of course, draws on § 701(a)(2), which precludes judicial review when "agency action is committed to agency discretion by law."[213] As the Supreme Court held in the *Overton Park* case,[214] the exception for action committed to agency discretion is a "very narrow exception. . . . The legislative history of the APA indicates that it is applicable in those rare instances where 'statutes are drawn in such broad terms that in a given case there is no law to apply.'"[215] The "no law to apply" language can be understood as itself compelling evidence that a decision has been left to agency discretion or as merely one piece of whether a particular subject has been "committed to agency discretion."[216] In *Heckler v. Chaney*,[217] the Supreme Court interpreted the provision as applying when "the statute is drawn so that a court would have no meaningful standard against which to judge the agency's exercise of discretion."[218]

Whether one gives wide or narrow effect to a statute containing "no law to apply," it would not seem to provide a very strong argument in the context of the hypo. While it is true that the EESA provides no guidance in how the Treasury is to exercise its rights as a holder of "troubled assets," there is no

212. 5 U.S.C. § 706(2)(A) (2006).

213. *Id.* § 701(a)(2).

214. Citizens to Preserve Overton Park, Inc. v. Volpe, 401 U.S. 402 (1971).

215. *Id.* at 410 (quoting S. REP. NO. 79-752, at 26 (1945)).

216. STEPHEN G. BREYER ET AL., ADMINISTRATIVE LAW AND REGULATORY POLICY 791 (6th ed. 2006).

217. 470 U.S. 821 (1985).

218. *Id.* at 830.

evidence that Congress expected the Treasury to acquire equity securities and thus no evidence at all that Congress committed the management of conflicts of interest created by control-equity positions to agency discretion.

We see, yet again, how hard it is to insert the substance of corporate law's fiduciary-duty analysis into a public law framework.

e. Claims Under the Freedom of Information Act.—In yet another example of how everything changes when the government is the controlling shareholder, it is worth noting that the definition of "agency" for the purposes of the Freedom of Information Act[219] (FOIA) includes a "[g]overnment controlled corporation."[220] Indeed, the effect of FOIA may go even further. On President Obama's first day in office, he issued a Memorandum on the Freedom of Information Act directing his incoming attorney general to reestablish a presumption in favor of disclosure of government records as well as ordering agencies to take "affirmative steps to make information public. They should not wait for specific requests from the public. All agencies should use modern technology to inform citizens about what is known and done by their Government."[221]

Take new GM, the successor to GM, of which the government still owns 26%. What information can be secured pursuant to FOIA that is not already available under either SEC disclosure regulations or sections 219 and 220 of Delaware General Corporation Law?[222]

Particularly relevant for these purposes is the exclusion of "inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency."[223] Although this limits the scope of material that can be secured under FOIA, it leaves undisturbed the advantages in timing: the FOIA will be most useful in gathering information prior to filing a complaint. Sections 219 and 220 of Delaware law are sharply limited in what can be secured,[224] while the FOIA

219. 5 U.S.C. § 552 (2006).

220. *Id.* § 552(f)(1).

221. Memorandum on the Freedom of Information Act, 2009 DAILY COMP. PRES. DOC. 9 (Jan. 21, 2009).

222. New GM is a Delaware corporation. *See* First Amendment to Amended and Restated Master Sale and Purchase Agreement (June 30, 2009), *available at* http://www.nclc.org/autobankruptcies/AmendmenttoGMARMSPA.pdf.

223. 5 U.S.C. § 552(b)(5).

224. *See, e.g.*, Sec. First Corp. v. U.S. Die Casting & Dev. Co., 687 A.2d 563, 570 (Del. 1997) ("A Section 220 proceeding should result in an order circumscribed with rifled precision."); Rainbow Navigation, Inc. v. Pan Ocean Navigation, Inc., 535 A.2d 1357, 1360 (Del. 1987) ("[E]stablishing oneself as a stockholder of record [under Section 219] is a mandatory condition precedent to the right to make a demand for inspection . . . .").

exception provides support for a strong presumption in favor of being able to get all material that *would* be available by law to a party in litigation.[225]

E. An Alternative Strategy: Leaving the U.S. Government Out of the Suit

So far, we have assumed as inevitable that the lawsuit will end up either in federal district court or the Court of Federal Claims. After the above analysis, one might conclude that trying to sue the federal government as a controlling shareholder is too hard to be worthwhile. Is there an alternative approach that dispenses with the federal government that would allow the cause of action to remain in the Delaware Court of Chancery to be adjudicated under Delaware law?

In a related article, we have argued that there are credible claims that could be brought against the directors under Delaware law.[226] But this then raises subsequent and important questions: Should Delaware courts want such a case? Should plaintiffs want to bring such a case in Delaware? And, finally, how should Delaware avoid a case, should it decide that the case puts Delaware in an impossible position?

In our related article, we argue that the plausible claims against the directors hold the potential to threaten Delaware's place in the corporate law landscape.[227] In such a case, the key questions would be (1) how the Treasury behaved, (2) would the case involve depositions of top Treasury officials, and (3) were a Delaware court to enjoin the transaction, would this risk provoking a confrontation with Washington? In light of Delaware's vulnerable position, plaintiffs would be wise to avoid a Delaware forum, and Delaware courts, were such a claim filed, should avoid adjudicating such claims if they can do so.

How, then, might Delaware dodge the bullet? We argue that Delaware Chancery Court Rule 19, the Delaware parallel to Federal Rule of Civil Procedure 19, the "indispensable party" rule, provides sufficient discretion to avoid a confrontation. By using the discretion provided by this rule of procedure, Delaware could "duck" the question without significantly compromising Delaware corporate law doctrine, the parties' ability to resolve the dispute, or Delaware's place in the corporate law landscape.

F. Conclusion

For a litigator, this is a pretty depressing Part. The bottom line is that when the Treasury is the controlling shareholder, the legal basis for challenging conduct that would normally constitute a clear breach of the duty of

225. For a fuller treatment of the law governing the scope of this exception, see RICHARD J. PIERCE, JR., ADMINISTRATIVE LAW TREATISE § 5.11 (5th ed. 2010).

226. Kahan & Rock, *supra* note 111, at 410.

227. *Id.* at 427–28.

loyalty or care is very weak. GM's S-1 concisely and conclusorily takes an even more negative view when, after explaining that shareholders will not have any redress under the federal securities laws, it concludes,

> Further, any attempt to assert a claim against the UST or any of its officers, agents or employees alleging any other complaint, including as a result of any future action by the UST as a stockholder of the Company, would also likely be barred under sovereign immunity unless specifically permitted by act of Congress.[228]

Although the claims against the directors or to enjoin the transaction are stronger, they put Delaware into a no-win situation, which Delaware would be well-advised to avoid. It may be that a creative and courageous judge will manage within the confines of existing law to enjoin or sanction the conduct in the opening hypothetical, but when one compares the legal structure described above to the robust protections of noncontrolling shareholders in the fully private context, there is not much room for optimism.

For transactional lawyers, the reaction may be even stronger. Even if the legal basis could be strengthened, this seems like a crazy way to handle the conflicts of interest created by government ownership of equity stakes in private companies. Is there a better way to set things up so these impossible problems do not arise? If there is not, then we ought to end the experiment as quickly as possible.

IV. Structuring Government Ownership Ex Ante

Government ownership is a political decision. How involved should the state be in private industry? To what extent should the government make day-to-day business decisions or set long-term strategy? Is government ownership a long-term arrangement or a short-term fix? For whom should a government-controlled firm be managed? Among countries and over time, one observes a huge variation in attitudes toward, and structures of, government ownership.

Implicit in the preceding Parts is the assumption that government use of its controlling interest in one portfolio company to aid another or to influence business strategy is problematic. But that, of course, assumes a particular political choice about the appropriate role of government that is obviously contestable.

The legal structure of government ownership—how the shares are held; whether ownership is complete, controlling, or minority; the role of courts; etc.—is important in a number of ways.

First, it is part of the way in which political choices are implemented—not the whole story, to be sure, but an important piece.

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228. General Motors Co., Amendment No. 9 (Form S-1), at 35 (Nov. 17, 2010), *available at* http://www.sec.gov/Archives/edgar/data/1467858/000119312510262471/ds1a.htm#rom45833_2.

Second, the legal structure, which itself is a product of fundamental political choices, provides a window into what those choices have been.

Third, existing legal "technology" sets a limit on political choices: we cannot choose what we cannot implement.

In this Part, we examine a variety of contemporary examples of how government ownership has been structured. In thinking through these questions of organizational design, there are a variety of dimensions—design choices, if you will—to keep in mind:

- What is the goal of government ownership? Profit? Security? Preserving national champions? Consumer welfare?
- What is the term of governmental involvement? Short term? Long term? Indefinite?
- To what extent are firm decisions insulated from political influence?
- How are decision makers held accountable? Through political mechanisms? Legal mechanisms? Not at all?

Given the historical variety of government involvement, a striking feature of the current arrangements is the widespread acceptance of a number of features, at least at the rhetorical level: first, that the goal of government involvement is to preserve or create firms that can thrive in competitive markets without continuing government support; second, that government involvement should be a short-term intervention that is justified by extraordinary circumstances; and third, that business decisions should be insulated from government influence.

Consider, in this regard, the Obama Administration's articulated principles for managing ownership interests in private firms, including its then-61% ownership stake in the new GM:

- "The government has no desire to own equity stakes in companies any longer than necessary, and will seek to dispose of its ownership interests as soon as practicable."
- "In exceptional cases where the U.S. government feels it is necessary to respond to a company's request for substantial assistance, the government will reserve the right to set upfront conditions to protect taxpayers, promote financial stability and encourage growth."
- "After any up-front conditions are in place, the government will protect the taxpayers' investment by managing its ownership stake in a hands-off, commercial manner."

- "As a common shareholder, the government will only vote on core governance issues, including the selection of a company's board of directors and major corporate events or transactions."[229]

The Organisation for Economic Co-operation and Development (OECD) Guidelines on Corporate Governance of State-Owned Enterprises takes a similarly "liberal" approach.[230]

Although one might doubt the sincerity of some of these utterances, the desire of the U.S. government to exit government ownership seems genuine. Substantial steps have been taken to reduce government ownership of Citigroup, GM, and AIG (although with the perverse effect of increasing it, at least temporarily, to 92.1%). The articulated goals of the Obama Administration are a version of classic liberal political economy. If we take this (perhaps merely rhetorical) consensus as given, the design analysis within these bounds becomes more tractable and more interesting. The key questions become a matter of means: Which legal structures for government intervention are more likely to achieve the stipulated goals? As we examine the different structures of government ownership, we will see a variety of approaches.

A. U.S. Models

In the extreme conditions of 2008 and 2009 with the ad hoc and rushed responses to the unfolding crisis described above, many of the U.S. Treasury's investments in private corporations were made directly with no binding governance structure. As a result, the U.S. Treasury directly holds the stakes in GM, Chrysler, GMAC, Citigroup, Fannie Mae, and Freddie Mac. This direct-ownership regime, as we discussed earlier, exposed GM and Chrysler to direct lobbying by politicians over GM and Chrysler decisions to close distribution facilities and dealerships in key congressional districts. As such, "direct ownership" provides the problematic baseline against which alternative ownership structures should be measured.

1. Chrysler 1.0.—The first Chrysler bailout was in late 1979 and early 1980 and was structured as a debt-guarantee program rather than a direct injection of capital. Under the Chrysler Corporation Loan Guarantee Act of 1979,[231] the U.S. government provided up to a maximum of $1.5 billion in loan guarantees. The structure was somewhat different from what we ob-

229. Press Release, White House, Obama Administration Auto Restructuring Initiative: General Motors Restructuring (May 31, 2009), http://www.whitehouse.gov/the-press-office/fact-sheet-obama-administration-auto-restructuring-initiative-general-motors.

230. OECD, OECD GUIDELINES ON CORPORATE GOVERNANCE OF STATE-OWNED ENTERPRISES (2005), *available at* http://www.oecd.org/dataoecd/46/51/34803211.pdf. Because the OECD guidelines are long on goals and short on recommended institutional arrangements, the guidelines do not represent an independent model for structuring government ownership.

231. 15 U.S.C. §§ 1861–1875 (1982).

serve today, partially explained by the fact that although the country was in a recession, debt and equity markets were functioning. The first Chrysler bailout had several important features.

First, a Chrysler Corporation Loan Guarantee Board was established, comprised of the Secretary of the Treasury, the Chair of the Federal Reserve, and the Comptroller General, with the Secretaries of Labor and Transportation as ex officio, nonvoting members.[232]

Second, the board had authority to provide loan guarantees "on such terms and conditions as it deemed appropriate" but only if the board determined that Chrysler had met a variety of conditions, including an energy-savings plan, a satisfactory operating plan, and a financing plan that would raise equivalent amounts of nonfederally guaranteed debt.[233]

Loan guarantees could be issued under the Act only if the board determined that credit was not otherwise available on reasonable terms and that there was reasonable assurance that Chrysler would pay the money back. Chrysler was charged a guarantee fee (of not less than .5% per year), and the board was expected "to the maximum extent feasible [to] ensure that the Government is compensated for the risk assumed in making guarantees," including "enter[ing] into contracts under which the Government, contingent upon the financial success of the Corporation, would participate in the gains of the Corporation or its security holders."[234] The U.S. government received 14.4 million warrants to purchase Chrysler stock at $13 per share until 1990.[235] In 1983, the U.S. government auctioned these warrants, and Chrysler purchased them for $311 million.[236]

Finally, a variety of creditor protective covenants were imposed, including veto rights over unapproved sales of assets, large contracts (including future collective-bargaining agreements), and a limitation on dividends.[237] In addition, no guarantees could be issued after December 31, 1983,[238] and all guarantees expired and all loans had to be repaid before December 31, 1990.[239]

The most striking difference between the first Chrysler bailout and the current bailout is the contrast between the debt model used in the 1970s and the private-equity model used this time around. Although debt holders certainly are able to control firms in certain circumstances, the private-equity model typically puts control at its center. In choosing the private-equity

232. *Id.* § 1862.

233. *Id.* § 1863.

234. *Id.* § 1864(d).

235. JAMES M. BICKLEY, CONG. RESEARCH SERV., R 40005, CHRYSLER CORPORATION LOAN GUARANTEE ACT OF 1979: BACKGROUND, PROVISIONS AND COST 5 (2008).

236. *Id.*

237. 15 U.S.C. § 1870.

238. *Id.* § 1875.

239. *Id.* § 1868.

model and relying on modifications of Simpson Thacher's private-equity documents, the current intervention was tilted, from the outset, toward control.

2. The AIG Structure: An Explicit Trust.—On September 16, 2008, the Federal Reserve rescued AIG by pledging $85 billion.[240] As part of the package, stated in the Federal Reserve's press release, "The U.S. government will receive a 79.9 percent equity interest in AIG and has the right to veto the payment of dividends to common and preferred shareholders."[241] On October 8, 2008, as AIG continued to spiral downward, the Federal Reserve pledged another $37.8 billion.[242] On November 10, 2008, additional funds were invested through TARP.[243]

The equity stake, noted in the initial press release, was not issued until March 2009. When the stock was ultimately issued on March 4, 2009, as Series C Preferred Stock, it represented 77.9% of the voting power.[244] It was issued to a trust established for the sole benefit of the Treasury.

The terms of the stock issuance and the trust are both interesting. As to the stock, Series C Preferred Stock, in addition to carrying 77.9% of the votes and an equivalent right to dividends, it also requires that "AIG and AIG's Board of Directors are obligated to work in good faith with the Trust to ensure that AIG's corporate governance arrangements are satisfactory to the Trust."[245]

The stock was issued to the "AIG Credit Facility Trust," which was established by the Federal Reserve Bank of New York (FRBNY). In the trust agreement, there is an explicit recognition of the potential conflicts of interests that can arise from the stock ownership: "WHEREAS, to avoid any possible conflict with its supervisory and monetary policy functions, the FRBNY does not intend to exercise any discretion or control over the voting and consent rights associated with the Trust Stock."[246]

In addition, there is also a recognition of the dangers of excessive interference:

> WHEREAS, the FRBNY anticipates that the Trustees will leave the day-to-day management of the Company to the persons charged with

240. Press Release, Bd. of Governors of the Fed. Reserve Sys., *supra* note 12.

241. *Id.*

242. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Oct. 8, 2008), *available at* http://www.federalreserve.gov/newsevents/press/other/20081008a.htm.

243. Press Release, Bd. of Governors of the Fed. Reserve Sys. (Nov. 10, 2008), *available at* http://www.federalreserve.gov/newsevents/press/other/20081110a.htm.

244. Am. Int'l Grp., Inc., Quarterly Report (Form 10-Q) (Mar. 2, 2009). The government stake was reduced to approximately 77.9% from the original 79.9% because of warrants for approximately 2% that were issued to the Treasury in November 2008. *Id.* at 10–11.

245. *Id.*

246. AIG Credit Facility Trust Agreement, *supra* note 182, at 2.

> such management, and will limit their involvement in the corporate governance of the Company to the exercise of the rights set forth in this Trust Agreement.[247]

In the operative provisions of the Trust, the trustees, appointed by the FRBNY in consultation with the Treasury, are given the power to exercise all shareholder rights, including rights to vote on charter amendments, bylaw amendments, election of directors, removal of directors, and anything else.[248] Although given complete discretion, the FRBNY included provisions expressing its views on the proper goals of the Trust:

> In exercising their discretion hereunder with respect to the Trust Stock, the Trustees are advised that it is the FRBNY's view that (x) maximizing the Company's ability to honor its commitments to, and repay all amounts owed to, the FRBNY or the Treasury Department and (y) the Company being managed in a manner that will not disrupt financial market conditions, are both consistent with maximizing the value of the Trust Stock.[249]

At the same time, there are a few restrictions built in. The Trustees may not themselves serve as directors[250] nor vote to elect as directors anyone who is or has recently been an employee of the FRBNY or the Treasury.[251] The Trustees may not be officers or employees of the FRBNY, the Treasury, or AIG, or be the parent, spouse, or child of anyone who is.[252]

The standard of care imposed on the trustees is extremely capacious:

> A Trustee shall have no liability hereunder for any action taken or refrained from or suffered by such Trustee, provided that such Trustee (i) acted in good faith in a manner the Trustee reasonably believed to be in accordance with the provisions of this Trust Agreement and in or not opposed to the best interests of the Treasury and (ii) had no reasonable cause to believe his or her conduct was unlawful . . . .[253]

The initial and, at the time of this writing, only trustees of the AIG trust are Jill Considine, Chester Feldberg, and Douglas Foshee.[254] Considine formerly was the Chair and CEO of the Depository Trust & Clearing Corporation and currently serves as a director of the Interpublic Group of

247. *Id.*
248. *Id.* § 2.04.
249. *Id.* § 2.04(d).
250. *Id.* § 2.04(f).
251. *Id.* § 2.04(e).
252. *Id.* § 3.01.
253. *Id.* § 3.03(a).
254. *Who Are the Trustees?*, INFO. ABOUT THE AIG TRS., http://www.aigcreditfacilitytrust.com/Home_1121_238661.html.

Companies and Ambac Financial Group Inc.[255] Chester Feldberg was Chair of Barclays Americas from 2000 to 2008 after having been executive vice president in charge of bank supervision at the New York Federal Reserve.[256] Douglas Foshee is president and CEO of El Paso Corporation, a publicly held gas-pipeline company, and previously worked at Halliburton.[257]

How well does this approach protect against the temptations identified above? AIG, from the outset, has fought to run its business "on a commercial basis." The initial bonus scandal exposed it to political condemnation and forced changes in compensation policies prospectively. Indeed, compensation has been such a salient issue that the current CEO, Robert Benmosche, reportedly threatened to resign if he was not permitted to pay key employees market rates.[258] The continuing involvement of Ken Feinberg, the compensation czar with authority over compensation in firms that have received TARP funding, complicated the management tasks and interfered with running the business "on a commercial basis," at least if this refers to how non-TARP financial institutions are managed.

As noted above, the trust is in the process of being dissolved, with the Treasury resuming direct ownership as a preliminary step to selling its shares.

3. Another U.S. Model: Limited Voting and Predetermined Exit at Citigroup.—The Treasury owned as much as 34% of Citigroup as a result of exchanging the preferred stock it purchased with TARP funds for common stock. As part of that exchange offer, the Treasury agreed to two interesting provisions. First, it limited its voting rights slightly by agreeing to vote its shares in the same proportions as other common stockholders, except with respect to major decisions—including election or removal of directors, amendments to the charter, and any sale of the company.[259] Second, the Treasury committed to disposing of the stock within ten years.[260]

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255. Press Release, Fed. Reserve Bank of N.Y., Statement Regarding Establishment of the AIG Credit Facility Trust: Trustees' CVs (Jan. 16, 2009), http://www.newyorkfed.org/newsevents/news/markets/2009/an090116.pdf.

256. *Id.*

257. *Id.*

258. Serena Ng et al., *Benmosche 'Committed' to AIG*, WALL ST. J., Nov. 12, 2009, at C1.

259. An amendment to Citigroup's S-4 filing contains this provision:

> *Voting of Common Stock.* The U.S. Treasury has agreed that it will vote all of its Common Stock in the same proportion as all other shares of Common Stock are voted, with respect to each matter on which holders of Common Stock are entitled to vote or consent other than with respect to the following matters: (i) the election and removal of directors, (ii) the approval of any merger, consolidation, statutory share exchange or similar transaction that requires the approval of Citigroup's stockholders, (iii) the approval of a sale of all or substantially all of the assets or property of Citigroup, (iv) the approval of a dissolution of Citigroup, (v) the approval of any issuance of securities of Citigroup on which holders of Citigroup's Common Stock are entitled to

How well has this worked out for the Treasury or for Citigroup? It is hard to say. Like other TARP banks, Citigroup sought to free itself from restrictions associated with government involvement (mainly, one thinks, those having to do with compensation) by paying back the TARP investments.[261] At the same time, the Treasury was keen to sell its shares so that it could show a profit on its TARP investments. With the sale of the final block of Citigroup stock and the associated warrants at the end of 2010, the Treasury no longer has an equity stake. The real concern should be whether Citigroup, to avoid the TARP restrictions on executive compensation, has repaid the TARP funds before it was strong enough to do so.

B. U.K. Financial Investments Limited

In the fall of 2008, as AIG, Lehman, and other U.S. financial institutions were collapsing, so too were major institutions in the United Kingdom. With government investments or bailouts of, *inter alia*, Royal Bank of Scotland (RBS), Lloyds, Northern Rock, and Bradford & Bingley, the U.K. government found itself with significant and sometimes controlling equity stakes. In response, U.K. Financial Investments Limited (UKFI) was set up on November 3, 2008, to manage those investments.[262]

UKFI was set up as a company under the Companies Act with the U.K. Treasury as the sole shareholder. A key stated goal of the structure was to adopt "[r]obust institutional arrangements for keeping UKFI at arm's-length from Government, centred on the creation of a heavyweight UKFI board which will take all major decisions relating to UKFI's business and its management of the investments."[263] The board included, as acting chair, Glen Moreno, who is chairman of Pearson plc, previously served as CEO of Fidelity International, and worked for Citigroup in a variety of senior positions.[264] The CEO was John Kingman, who previously "was Second Permanent Secretary to the Treasury, where he was responsible for oversight

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vote and (vi) the approval of any amendment to the charter or bylaws of Citigroup on which holders of Common Stock are entitled to vote.

Citigroup, Inc., Amendment No. 5 (Form S-4), at 75–76 (July 17, 2009).

260. Another filing by Citigroup in connection with this transaction contains this provision:

> *Mandatory Sale Date.* If the U.S. Treasury owns any Common Stock or warrants convertible into such Common Stock on the tenth anniversary of the closing date of the Exchange Offers, then the U.S. Treasury agrees to use reasonable efforts to transfer to non-governmental entities on an annual basis at least 20% of the aggregate number of such shares owned by the U.S. Treasury until all of such shares are transferred.

Id. at 76.

261. Smith, Lucchetti & Crittenden, *supra* note 93.

262. U.K. FIN. INVS. LTD., AN INTRODUCTION: WHO WE ARE, WHAT WE DO, AND THE FRAMEWORK DOCUMENT THAT GOVERNS THE RELATIONSHIP BETWEEN UKFI AND HM TREASURY 1 (2009), *available at* http://www.ukfi.co.uk/releases/UKFI%20Introduction.pdf.

263. *Id.* at 11.

264. *Id.* at 3.

and control of some £600 billion of public spending annually."[265] The remainder of the board included an impressive group of directors with experience in business and government, a mix that was clearly intentional.

The "Framework Document" established the relationship between the Treasury and UKFI and provided guidelines to UKFI in managing the portfolio of Treasury shareholdings. It opens with the Treasury's overarching objective, namely, to dispose of the investments as soon as possible and, in the meantime, to preserve their value:

> The Company should, in compliance with the Investment Mandate described in Section 4, develop and execute an investment strategy for disposing of the Investments in an orderly and active way through sale, redemption, buy-back or other means within the context of an overarching objective of protecting and creating value for the taxpayer as shareholder, paying due regard to the maintenance of financial stability and to acting in a way that promotes competition.[266]

It follows with a commitment by the Treasury to produce an "investment mandate" in consultation with the board, which the company is to comply with in managing the investments, taking into account the overarching objective.[267] The board is then tasked with producing a business plan for the management of UKFI to recommend to the Treasury.[268]

With regard to management of the portfolio companies, UKFI is expected to concern itself with corporate governance by working with boards "to strengthen their membership through the appointment of suitably qualified, independent non-executives."[269] The Framework Document also commits to preserve the independence of portfolio companies:

> The Company will manage the Investments on a commercial basis and will not intervene in day-to-day management decisions of the Investee Companies (including with respect to individual lending or remuneration decisions). The Investee Companies will continue to be separate economic units with independent powers of decision and, in particular, will continue to have their own independent boards and management teams, determining their own strategies and commercial policies (including business plans and budgets).[270]

With respect to wholly owned companies, the Framework Document expects UKFI to act like a private-equity firm. With respect to partially owned public companies, it is expected to "engage actively . . . in accordance with best institutional shareholder practice," including exercising voting

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265. *Id.*
266. *Id.* at 9.
267. *Id.* at 11.
268. *Id.* at 15.
269. *Id.*
270. *Id.*

rights.[271] To avoid any distortion of competition, UKFI will ensure that there are no interlocking directors among its portfolio companies and is expected to take steps to ensure that portfolio companies comply with codes of conduct, abide by insider-trading prohibitions, and, most intriguingly, "exercise its rights in relation to each Investee Company individually and will not co-ordinate its actions in relation to Investee Companies in a way that might distort competition between them."[272]

Immediately after the paragraph ensuring independence, the Framework Document commits UKFI to

> monitor and work to secure compliance with the following: (A)(i) the non-lending conditions attached to the accessing by RBS and Lloyds (including HBOS plc) of the Government's bank recapitalisation fund and any other financial institutions accessing the fund and (ii) the conditions attaching to any decisions of the European Commission or national regulatory authorities in relation to state aid or merger control and any commitments given by HM Treasury in that context, as notified by HM Treasury to the Company (together, the "Recapitalisation Conditions").[273]

This section refers to obligations that these firms took on in agreeing to a bailout, "including maintaining, over the next three years, the availability and active marketing of competitively-priced lending to home owners and small businesses at 2007 levels."[274] Thus, for example, when the Treasury took 65% of the voting shares of Lloyds Banking Group in return for insuring £260 billion of the group's toxic assets, Lloyds agreed "to lend at least £28bn over the next few years."[275]

The remainder of the document commits UKFI to establish corporate-governance structures at portfolio companies that comport with "best practices" and expects UKFI itself to model these best practices.

The Treasury retains a veto over any disposal or acquisition of investments, any variation in the terms of any agreements with portfolio companies, and any action that may prejudice the Treasury's role as creditor. Finally, the Treasury has the "power of direction" and can give general or specific instructions at any time. The board agrees to comply with such instructions or to resign. Any such directions will be in writing and promptly published.

In the time that UKFI has been up and running, it has already taken some firm public positions. Thus, for example, it voted its 57.9% stake in

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271. *Id.*

272. *Id.* at 16.

273. *Id.*

274. Press Release, U.K. Fin. Invs. Ltd., UKFI Takes On Management of RBS Shares (Dec. 1, 2008), *available at* http://www.ukfi.co.uk/releases/ukfi_takes_on_mngmnt_rbs_shares.pdf.

275. Jill Treanor & Nick Mathiason, *Government Takes Over Lloyds*, GUARDIAN (U.K.), Mar. 7, 2009, http://www.guardian.co.uk/business/2009/mar/07/government-takes-over-lloyds.

RBS against the resolution to approve RBS's retrospective Remuneration Report because of the former board's decision to treat two outgoing executives' departures as retirements, thereby enabling the executives to take undiscounted and highly controversial pensions.[276]

The UKFI Framework Document embraces what one might optimistically call "constructive ambiguity" or more pessimistically view as incoherence. On the one hand, it adopts a model of "commercial" as distinguished from "political" management of the share portfolio and sets up a certain separation between the Treasury and the share portfolio.[277] It seemingly adopts a goal of increasing the value of the portfolio companies in order to facilitate the prompt sale of the ownership stakes. On the other hand, it leaves open numerous avenues of political influence, albeit with the potential safeguard of requiring that influence to be public, while also directing UKFI to fulfill the mandate to lend.[278] During a recessionary period, when lending opportunities decline, the two goals are in some tension.

Put somewhat differently, the U.K. model relies on nonlegally enforceable norms as opposed to binding legal structures to provide insulation. How well that will work will depend sensitively on the underlying norms relating to government interference in business decisions. The model, then, even if it works, can only be transplanted to systems with a similar set of norms.

Indeed, the structure, based as it is on norms, does little to insulate "commercial" decisions in the management of the portfolio from political pressure. The populist outcry over executive compensation provides a nice example. Fred Goodwin and Johnny Cameron's departures from RBS were highly controversial. When Goodwin, the CEO of RBS, stepped down after RBS's collapse, he received a pension of approximately £700,000 per year.[279] Although, by U.S. standards, this was hardly extreme, it generated a huge public outcry, in part because through manipulation of his departure date and other inputs to the pension determination, he received twice as much as he otherwise would have.[280] Goodwin became a symbol of excess and greed, and his house was vandalized.[281] UKFI then voted against the "Directors' Remuneration Report" at the next annual meeting.[282]

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276. Press Release, UK Fin. Invs. Ltd., UKFI Statement Re: RBS AGM Voting (Mar. 31, 2009), *available at* http://www.ukfi.co.uk/index.php?URL_link=press-releases&Year=2009.

277. U.K. FIN. INVS. LTD., *supra* note 262, at 19.

278. *Id.* at 20.

279. Myles Neligan, *Former RBS CEO Goodwin Agrees to Pension Cut*, REUTERS (June 18, 2009), http://www.reuters.com/article/idUSLI58536320090618.

280. Graeme Wearden & Jill Treanor, *Ex-RBS Chief Goodwin Faces Legal Challenge to £693k Pension*, GUARDIAN (U.K.), Feb. 26, 2009, http://www.guardian.co.uk/business/2009/feb/26/sir-fred-goodwin-royalbankofscotlandgroup.

281. Aislinn Simpson, *Sir Fred Goodwin Attack: Bank Bosses Are Criminals Group Claims Responsibility*, TELEGRAPH (U.K.), Mar. 25, 2009, http://www.telegraph.co.uk/finance/

Other examples are also revealing. In the summer of 2009, the Treasury apparently pressured Lloyds, of which it owns 43%, to restructure a loan to JJB Sports, a U.K. health-club chain with 9,000 employees, rather than selling the debt to a U.S. restructuring firm, which apparently was willing to pay face value.[283]

Later, when RBS, also controlled by the Treasury, announced that it was advising Kraft in its hostile bid for Cadbury and providing financing for the bid, severe pressure was brought to bear by two senior Labour politicians, Lord Mandelson, the Secretary of State for Business, Innovation and Skills and President of the Board of Trade, and Lord Myners, the Financial Services Secretary (or City Minister) in the Treasury, as well as by other members of parliament.[284]

Political pressure, especially in the absence of binding legal restrictions, can be very persuasive.

C. The Israeli Approach: The 1983 Bank Bailout

In 1983, after a scheme by the major Israeli banks to manipulate the price of their shares collapsed and the banks were left holding huge blocks of their own shares, the government stepped in and assumed control of the banks. This led to a period, now essentially ended, during which the Israeli government owned controlling positions in the major banks.[285]

By 1983, at least with regard to the bank bailouts, Israel had accepted the "liberal consensus." To avoid government involvement in the day-to-day management of the banks and to facilitate the subsequent sale of the shares, the Bank Shares Arrangement Law[286] adopted an innovative structure. For

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newsbysector/banksandfinance/5048091/Sir-Fred-Goodwin-attack-Bank-Bosses-Are-Criminals-group-claims-responsbility.html.

282. In the United Kingdom, public companies must publish and submit an annual "Directors' Remuneration Report" detailing the compensation of top executives for approval at the annual general meeting. The Directors' Remuneration Report Regulations, 2002, S.I. 2002/1986, art. 3, ¶ 3 (U.K.), *available at* http://www.legislation.gov.uk/uksi/2002/1986/made (providing regulations made by the Secretary of State pursuant to section 257 of the Companies Act 1985). A rejection has purely symbolic effect.

283. Elizabeth Rigby, *JJB Nearer to Fitness Club Sale*, FIN. TIMES, Mar. 23, 2009, at 18; *see also* David Wighton, *Hester Hits Out at Interference*, TIMES (U.K.), Dec. 17, 2009, http://business.timesonline.co.uk/tol/business/columnists/article6959732.ece (discussing the JJB Sports deal and stating that Lloyds failed to take advantage of an "apparently attractive" offer by a U.S. restructuring firm).

284. Jonathan Guthrie et al., *MPs Aim to Block Financing of Bid for Cadbury*, FIN. TIMES, Dec. 15, 2009, http://www.ft.com/cms/s/0/0e272be8-e9b5-11de-9f1f-00144feab49a,s01=1.html; *see also* Andrew Hill, *Mandelson on Cadbury: Pure Politics, Impure Policy*, FIN. TIMES, Dec. 5, 2009, at 15.

285. For an overview of the bank-share scheme, see Asher Blass & Richard Grossman, *Financial Fraud and Banking Stability: The Israeli Bank Crisis of 1983 and Trial of 1990*, 16 INT'L REV. L. & ECON. 461, 461–72 (1996), and Ehud Ofer, *Glass-Steagall: The American Nightmare that Became the Israeli Dream*, 9 FORDHAM J. CORP. & FIN. L. 527, 559–63 (2003).

286. Bank Shares Arrangement Law, 1438-1993, SH No. 2207 p. 378 (Isr.).

each bank, a "public committee" and a "share committee" were created. The members of the "public committee" were appointed by the government and charged with drawing up a list of candidates to serve as directors.[287] The members of the public committee must, by statute, include a judge (appointed by the Justice Minister after consulting with the President of the Supreme Court) who serves as chair, with the other four members who must include an academic and a business person, chosen by the Treasury Minister with the agreement of the president of the Bank of Israel. The members must meet the qualifications set forth for directors of government corporations and a variety of other competence and independence requirements.[288]

The "share committee," appointed by the public committee, is given both the power and responsibility to vote the shares for the State.[289] The members of the share committee likewise must meet standards of competence and independence.[290] The share committee nominates directors from the list of candidates prepared by the public committee and then votes for them at the annual meeting.[291] A person cannot serve on more than one share committee; a director may not serve on more than one bank board.[292] On proposals to change fundamental corporate documents, the share committee is to exercise its own discretion, except that it is directed to vote against all proposals that directly or indirectly weaken the rights attached to the government shares or the ability to sell those shares.[293]

When it comes to selling the shares, the Treasury Minister retains the power to order their sale and to approve any other plan to sell them, and the share committee is precluded from engaging in any share transaction except according to written instructions from the Treasury Minister or his agent and with the approval of the Knesset (parliament) Finance Committee.[294]

The Israeli statute provides a very detailed structure designed to insulate the day-to-day management of the banks from political interference by giving share-voting decisions to the share committee. At the same time, critical decisions—such as whether and when to sell the shares—are reserved for the political branches. Moreover, the structure, with its multiple agents and reporting requirements, makes it nearly certain that significant attempts to breach the firewalls will be publicly disclosed and thereby trigger public comment and debate. Finally, the Israeli structure provides a process for identifying and vetting director candidates that is independent from both the

287. *Id.* § 6(a).
288. *Id.* § 7.
289. *Id.* §§ 3, 12(a), 25.
290. *Id.* § 12.
291. *Id.* §§ 17–19.
292. *Id.* § 20(a).
293. *Id.* § 26.
294. *Id.* § 30.

banks themselves as well as from the political branches. According to anecdotal reports, the system works quite well.

Interestingly, Israel also has a separate "Government Corporations" statute that is designed for corporations in which the government owns more than 50%, with some provisions applying to "mixed corporations" (defined as corporations in which the government owns less than 50%). The key features of the statute include specific government approval rights over changes in the purposes of the corporation, its capital, and issuance of preferred stock or convertible bonds.[295] The statute also contains provisions governing government directors serving on the board,[296] provisions establishing a government corporation authority, provisions addressing subsidiaries and mixed corporations, as well as provisions governing privatization.[297] A subsection addresses "defense of essential governmental interests."[298]

The best-known example of a government corporation is El Al Israel Airlines, which was bailed out by the government in the early 1980s and privatized beginning in 2003. It has passed through each stage of government ownership. The government currently holds no equity ownership aside from a "special state share."[299]

D. The Design Choices and the Background Politics

Earlier, we pointed out that government ownership of equity can encourage political interference by providing the *power* to interfere, the regular *opportunities* to do so, and a low political *cost*. Taking the liberal consensus as given, one can analyze the various design choices according to their capacity to block political interference by reducing the power to interfere, minimizing the opportunities to do so, and increasing the political cost. The principal design choices seem to be

- Equity v. debt
- Voting v. nonvoting stock
- Direct v. indirect ownership
- Indefinite v. time-limited ownership.

295. Government Companies Law, 5735-1975, SH No. 770 p. 132, § 11 (Isr.).

296. *Id.* §§ 12–23.

297. *Id.* §§ 51–59(6).

298. *Id.* §§ 59(7)–59(2).

299. El Al Israel Airlines, Ltd., 2009 Annual Report at a-15, http://www.elal.co.il/NR/rdonlyres/DD3C12EE-AF21-448D-B732-4FED20ED922D/0/ELALFINANCIALSTATEMENTS2009_new.pdf. On the requirements imposed by the special state share, see *id.* § 9.11.9 at a-134 to a-137.

Once one lays out the alternatives, the task of implementing the liberal consensus is actually quite straightforward: a legally binding structure that insulates the firm from political pressure coupled with a quick exit. The fact that the available means are so rarely adopted suggests that, as a political matter, we may not in fact wish to implement the "liberal consensus," even as we pay homage to it.

1. Insulation Through Binding Separation.—Suppose one takes the liberal consensus at face value. How would ownership be structured? Here, we have at least two alternatives. First, as with Chrysler 1.0, one could build the investment on the debt model and impose a relatively short time limit. Putting these together, one provides very substantial insulation from political pressure. Debt provides far fewer opportunities for interference because debt holders do not typically vote for directors, on shareholder proposals, or to approve major transactions. If one wishes to give the taxpayer a share in the upside, that is easily done with warrants, as in Chrysler 1.0 and TARP. These warrants provide no control rights until exercised and even then can be limited to nonvoting stock. The public can benefit from increases in firm value either through exercising the warrants or, more typically, by selling the warrants back to the company or in an auction.

An additional advantage of investing through debt rather than equity is that it prevents shareholders of insolvent firms from benefiting from government bailouts. In the recent bailouts, why did the government limit its ownership to 79.9%, leaving 20.1% in the hands of existing shareholders? There are two explanations. One is that government accounting rules, like GAAP, require the consolidation of accounts when the government owns 80% or more. Had the government acquired 100% of AIG, Fannie Mae, or Freddie Mac, their massive debts would have had to be included in the national debt and would have required legislation raising the permissible ceiling. Because such legislation is always politically controversial,[300] it was politically easier (although economically costly) to leave the existing shareholders with 20%. An alternative explanation is that capping government ownership at 79.9% was necessary to maintain the deductibility of interest payments to the Treasury (although why it would matter to the government that such payments would be deductible is unclear).[301]

A second approach is to insulate firms from interference through a legally binding process for the appointment of directors and the voting of shares. The Israeli bank-shares model, with two separate, independent

300. *See, e.g.*, Corey Boles & Martin Vaughan, *Congress Increases Debt Limit*, WALL ST. J., Dec. 26, 2009, at A8; Carl Hulse, *Senate Passes an Increase in Debt Limit*, N.Y. TIMES, Dec. 24, 2009, http://www.nytimes.com/2009/12/25/business/25debt.html?emc=eta1.

301. Adam Levitin, *Why Have the Government Bailouts Involved Only a 79.9% Equity Position?*, CREDIT SLIPS (Sept. 18, 2008), http://www.creditslips.org/creditslips/2008/09/why-have-the-go.html.

committees, provides an example of how this can be implemented. Here, again, by limiting politicians' power and their opportunities to interfere, one can provide for very substantial insulation. For banks and other financial institutions with capital-adequacy requirements, government purchases of debt will not typically suffice. In such cases, the Israeli bank-shares model provides an alternative structure of binding insulation.

These approaches, when implemented properly, trump investments in nonvoting stock for two reasons. First, nonvoting stock gives the (nongovernmental) holders of the voting shares the residual control rights. By creating a dual-class capital structure, one divides cash-flow rights from control rights, resulting in the well-known problems that such division can cause.[302] Second, because nonvoting shares trade at a discount to voting shares, the government will get less when it ultimately sells its stake. By contrast, government ownership of voting shares allows it to exit by selling the block either to a new controller or into the market.

2. Mandating a Quick Exit.—In June 2009, Senate Bill 1280, the TARP Recipient Ownership Trust Act of 2009, was introduced in the Senate.[303] The proposed statute granted the Secretary of Treasury authority (and provided inducements to exercise that authority) to delegate the management of TARP positions of 20% or more to a management company run by three "independent trustees," who are expected to hold and manage the assets "in trust on behalf of the United States taxpayers."[304] Under the proposed statute, the duties of the trust would be to exercise the voting rights and select the representation on the boards of TARP recipients with "the purpose of maximizing the profitability of the designated TARP recipient."[305] Somewhat mysteriously, the proposed statute stated that the trust shall

> have a fiduciary duty to the American taxpayer for the maximization of the return on the investment of the taxpayer made under the Emergency Economic Stabilization Act of 2008, in the same manner and to the same extent that any director of an issuer of securities has with respect to its shareholders under the securities laws and all applications of State law.[306]

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302. *See* Ronald Gilson, *Evaluating Dual Class Common Stock: The Relevance of Substitutes*, 73 VA. L. REV. 807, 832–40 (1987) (noting that dual-class transactions create neutral or negative impacts on shareholder wealth and offering two possible explanations based on coercion of public shareholders by a dominant group); Jeffrey Gordon, *Ties that Bond: Dual Class Common Stock and the Problem of Shareholder Choice*, 76 CALIF. L. REV. 1, 23 (1988) (reporting statistical evidence that dual-class recapitalizations may decrease shareholder wealth).

303. S. 1280, 111th Cong. (2009).

304. *Id.* § 3.

305. *Id.*

306. *Id.*

Finally, the statute provided for the liquidation of the trust by the end of 2011, unless the trustees believe "that liquidation would not maximize the profitability of the company and the return on investment to the taxpayer."[307]

The bill raised as many questions as it answers, but the general outlines are reasonably clear: a politically independent vehicle to hold and vote the shares, a 2011 sunset, and some vague instructions to manage the assets with an eye toward profitability and, by implication, without political motivations or goals. The bill was referred to committee where it seems to have died.

Binding time limits on government ownership are the single most powerful means of insulating firms from political pressure. However troubling interference may be, a short time horizon minimizes the damage. On the other hand, while tempting, the obvious problem with mandating a sale is the trade-offs. Exit cannot be so quick as to jeopardize the firms that we are trying to save. Because we want to maximize the return to taxpayers, a forced sale will rarely maximize the price.

V. Conclusion

The preceding discussion shows that our current regulatory structure is ill adapted to government ownership of controlling stakes in private companies. Delaware's nuanced jurisprudence of fiduciary duty is not, and probably cannot be, duplicated or transplanted into the public law categories that come to the fore with public ownership.

This gap raises two possibilities. One might argue that because bailouts are inevitable, we should come up with a better system for holding governmental controlling shareholders accountable for the effects of their actions on noncontrolling shareholders. If one went in this direction, one might argue that Delaware corporate law should be incorporated by reference through some sort of inverse preemption. Alternatively, in recognition of the different incentives and goals of government controlling shareholders, one might argue for the development of a new set of standards better suited to the distinctive issues posed by government ownership of controlling stakes.

An alternative view is that, given the difficulties inherent in government ownership, the last thing we should do is make it easier. On this view, providing a better accountability system will only serve to encourage government intervention and further reduce whatever political taboos remain against it. Because no regulatory structure can adequately control the political forces at play, it may even be the case that we should preserve the current, ill-fitting system as is. The worse the outcome, one might argue, the better for the long-term health of the body politic because there is no other way to reestablish the necessary taboos.

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307. *Id.*

However one comes out on the direction forward, one thing is clear: we do not currently have adequate legal tools to address the problems posed when the government is the controlling shareholder.

Book Review

Federalism Compatibilists

POLYPHONIC FEDERALISM. By Robert A. Schapiro. Chicago, The University of Chicago Press. 2009. Pp. 237, $45.00.

Reviewed by Garrick B. Pursley*

Introduction

A gulf separates federalism in courts from federalism in practice. There is one federalism that our courts—the United States Supreme Court in particular—appear to believe that we have (or should have); and then there is another federalism that operates in the actual day-to-day processes of governance. These two federalisms are quite distinct and their incongruence is striking. Professor Robert Schapiro's ambitious *Polyphonic Federalism*[1] aims to explain the causes of this disconnect and suggest ways to reconcile judicial conceptions with the realities of federalism in practice.

Current federalism doctrine—characterized by what Schapiro calls "dualism," or "the view that principal authority for regulating a subject must be allocated to either the national government or state governments"[2]—seems designed to defend a governmental regime of separate spheres of federal and state authority that no longer exists in the United States, perhaps never did, and certainly could not be reestablished without costly upheaval of much of the current system.[3] The Supreme Court has, in the last fifteen years or so, renewed efforts to mark off a boundary between "truly national" matters properly subject to federal regulation and "truly local" matters

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1. ROBERT A. SCHAPIRO, POLYPHONIC FEDERALISM (2009).

2. *Id.* at 55.

3. *Id.* at 55–56. Schapiro contends that most academic debate about federalism is similarly mired in dualism. *Id.* at 55, 72. He acknowledges, though, that some have begun to "move from a categorical concept of areas of national and local authority to a structural notion of dual, overlapping levels of government." *Id.* at 87. I think his view of federalism scholarship may be overly dim: many of those I will call "conventionalist" federalism scholars, like Ernest Young, reject "dualism" as outmoded and counterproductive. *See, e.g.*, Ernest A. Young, *Dual Federalism, Concurrent Jurisdiction, and the Foreign Affairs Exception*, 69 GEO. WASH. L. REV. 139, 157–61 (2001) [hereinafter Young, *Dual Federalism*] (critically analyzing recent Commerce Clause jurisprudence to determine whether the Court's effort to carve out a limited sphere of activity "off limits" to federal regulation signals a return to "the *sins* of dual federalism" (emphasis added)).

subject to autonomous state control.[4] Thus, for example, after a half century of no judicially enforced limitation on Congress's power under the Commerce Clause, the Supreme Court in *United States v. Lopez*[5] struck down the federal Gun Free School Zones Act on the ground that it addressed a "noncommercial" matter properly subject to state, not federal, regulatory authority.[6] In practice, however, this separate-spheres image breaks down immediately. The two levels of government often cooperate, sometimes clash, but nearly always interact in one way or another in conducting their affairs.[7] The No Child Left Behind Act (NCLB),[8] for example, constitutes federal intervention in education, a traditionally "local" issue,[9] to establish a "*joint* state-federal effort to improve education" in which "[s]tates have some discretion in implementing the program, subject to various federal guidelines."[10] Interactive federal–state regulatory regimes like this are ubiquitous today.[11] The obvious gap between doctrine and practice presents a question: Do the courts just have the requirements of federalism profoundly wrong, or are vast swaths of contemporary government practice inconsistent with the Constitution's basic structural norms?

There are two typical academic responses. If we assume *arguendo* that Supreme Court doctrine represents a more-or-less correct understanding of real constitutional requirements, then it appears that government practice stands in tension with the Constitution. On what I will call a "conventionalist" view, one might be tempted to say that because the Constitution is the supreme law of the land, adopted and continued in effect by acts of popular sovereignty, government practices simply must be invalidated if they violate it, regardless of the instrumental benefits—creating efficiencies, leveraging local expertise, promoting regulatory pluralism and

4. SCHAPIRO, *supra* note 1, at 61–62; *see* United States v. Morrison, 529 U.S. 598, 617–18 (2000) ("The Constitution requires a distinction between what is truly national and what is truly local. In recognizing this fact we preserve one of the few principles that has been consistent since the [Commerce] Clause was adopted." (citations omitted)).

5. 514 U.S. 549 (1995), *superseded by statute*, Omnibus Consolidated Appropriations Act, 1997, Pub. L. No. 104-208, § 101(f), 110 Stat. 3009, 3009-369 to -370 (1996) (modifying 18 U.S.C. § 922(q)(2)(A) to require a nexus with interstate commerce).

6. *Id.* at 566–67.

7. On conflict in these interactions in particular, see Jessica Bulman-Pozen & Heather K. Gerken, *Uncooperative Federalism*, 118 YALE L.J. 1256 (2009).

8. No Child Left Behind Act of 2001, 20 U.S.C. §§ 6301–6578 (2006).

9. *See* Milliken v. Bradley, 418 U.S. 717, 741 (1974) ("No single tradition in public education is more deeply rooted than local control over the operation of schools . . . .").

10. SCHAPIRO, *supra* note 1, at 103 (emphasis added); *see also* Bulman-Pozen & Gerken, *supra* note 7, at 1282 (noting that states have used this flexibility to resist full implementation of NCLB).

11. *See* Bulman-Pozen & Gerken, *supra* note 7, at 1283–84 (describing state enforcement of federal marijuana regulation); Michael O'Hear, *Federalism and Drug Control*, 57 VAND. L. REV. 783, 806–07 (2004) (noting the overlap of state and federal drug regulation); sources cited *infra* notes 14, 20–21.

beneficial regulatory redundancies, etc.—that the practices generate.[12] In short, the structural conventions entrenched in the Constitution should be maintained regardless of the benefits of possible alternative arrangements. I discuss this sort of argument in more depth below. But one thing to notice here is the implicit interpretive premise that the instrumental value of a practice *by itself* is insufficient to justify an interpretation or strategy of judicial enforcement of structural constitutional requirements that would render the practice constitutionally permissible.[13] This, I will argue, is a principal point of disagreement between these conventionalists and their interlocutors.

The other increasingly common academic response is to embrace modern intergovernmental practices and argue that, primarily *because of* their instrumental benefits, they should be constitutionally permissible. I will call arguments that attempt to reconcile modern practice with constitutional federalism requirements "compatibilist" arguments.[14] A growing chorus of scholars, in which Schapiro's is a leading voice, emphasizes the value of the cooperation, interaction, and even conflict between the national and state governments that characterize modern practice. Where judicial federalism doctrine endangers these beneficial features, these compatibilists argue, it should be replaced with one of several alternative doctrinal arrangements bearing distinct but thematically related names like "adaptive," "dynamic," "cooperative," "iterative," or "empowerment" federalism.[15] Thus far, however, this "new federalism" literature lacks a rigorous defense of the compatibilist normative claim that constitutional doctrine *should* be revised

12. *See, e.g.*, Stuart Minor Benjamin and Ernest A. Young, *Tennis with the Net Down: Administrative Federalism Without Congress*, 57 DUKE L.J. 2111, 2141–43 (2008) (critiquing functionalist proposals to harmonize administrative law with federalism requirements); *cf.* Gary Lawson, *The Rise and Rise of the Administrative State*, 107 HARV. L. REV. 1231, 1249 (1994) (providing a similar critique with respect to separation-of-powers norms).

13. Some who would make this objection profess general interpretive views that seem to commit them to rejecting purely instrumental justifications for interpretation or doctrinal development in most contexts. *See, e.g.*, Ernest A. Young, *Making Federalism Doctrine: Fidelity, Institutional Competence, and Compensating Adjustments*, 46 WM. & MARY L. REV. 1733, 1736, 1739 (2004) (arguing that constitutional interpretation and doctrine should both account for instrumental considerations *and* display "fidelity" to broad original understandings).

14. Professors Galle and Seidenfeld have dubbed this kind of view "constitutional realism." *See* Brian Galle & Mark Seidenfeld, *Administrative Law's Federalism: Preemption, Delegation, and Agencies at the Edge of Federal Power*, 57 DUKE L.J. 1933, 1938–39 (2008) ("Th[e] move to realism is significant because the claims of congressional primacy can be defended . . . only on formalist grounds.").

15. On "empowerment" federalism, see, for example, ERWIN CHEMERINSKY, ENHANCING GOVERNMENT: FEDERALISM FOR THE 21ST CENTURY 99 (2008), and Erwin Chemerinsky, *Empowering States: The Need to Limit Federal Preemption*, 33 PEPP. L. REV. 69, 74 (2005). On cooperative or interactive federalism, see, for example, DANIEL J. ELAZAR, AMERICAN FEDERALISM: A VIEW FROM THE STATES 84 (2d ed. 1972); Daniel J. Elazar, *Cooperative Federalism*, *in* COMPETITION AMONG STATES AND LOCAL GOVERNMENTS: EFFICIENCY AND EQUITY IN AMERICAN FEDERALISM 65 (Daphne A. Kenyon & John Kincaid eds., 1991); Susan Rose-Ackerman, *Cooperative Federalism and Co-optation*, 92 YALE L.J. 1344, 1344 (1983); Philip J. Weiser, *Towards a Constitutional Architecture for Cooperative Federalism*, 79 N.C. L. REV. 663, 665 (2001).

to accommodate contemporary intergovernmental practices in virtue of their instrumental benefits.[16] Critics have charged that compatibilist arguments in administrative federalism, for example, "give zero attention to claims that the Constitution may simply require" certain institutional arrangements and processes—such as a sharp distinction between "national" and "local" subjects of regulation, a mandatory congressional role in authorizing federal administrative agencies to preempt state law, and so on—"not because [the compatibilists] are unaware of such arguments but because such arguments do not count in their jurisprudential world."[17] Arguments about pragmatic value, on the conventionalist view, are insufficient to establish constitutionality. This and similar criticisms that might be lodged in other contexts depend on the conventional view that constitutional interpretation and enforcement require something more than accounting for pragmatic considerations, such as attention to historical understandings of constitutional meaning or abstract moral reasoning or reference to current political or social consensuses as to desirable policy outcomes.[18] Compatibilists have failed, so far, to "translate" their claims about the functional benefits of interactive federalism arrangements into the conventional language of debates about constitutional interpretation and doctrine-making.[19] What is missing is a theory of constitutional interpretation that establishes pragmatic value as a decisive criterion for constitutionality, interpretive arguments for constitutionality different from or in addition to arguments about pragmatic value, or, barring those, a reason to think that compatibilists are making something other than a claim about constitutional interpretation.

Professor Schapiro has for years been a standard bearer for compatibilism.[20] While interactive accounts of federalism have been brought

16. *See* SCHAPIRO, *supra* note 1, at 85–91 ("[T]he institutional competence decision must follow from a normative theory of federalism. The institutional decision cannot simply replace the need for a theory of federalism.").

17. Benjamin & Young, *supra* note 12, at 2119 (emphasis omitted).

18. *See* Lawrence Lessig, *Translating Federalism:* United States v. Lopez, 1995 SUP. CT. REV. 125, 127 (defending a "technique of interpretive fidelity" in which courts must "apply [the Constitution] today in a way that preserves that original meaning"); Young, *supra* note 13, at 1774 ("[F]ederalism's prominent place in the original constitutional design, as well as its continuing significance in the years since, impose an obligation of fidelity to the federal balance between the states and the nation.").

19. *Cf.* Benjamin & Young, *supra* note 12, at 2138–39 (characterizing such arguments, in the administrative law context, as "a departure from more familiar forms of constitutional doctrine" and "from more traditional assumptions about constitutional structure").

20. *See generally* Robert A. Schapiro, *Justice Stevens's Theory of Interactive Federalism*, 74 FORDHAM L. REV. 2133, 2135 (2006) (advocating "interactive" federalism); Robert A. Schapiro, *Polyphonic Federalism: State Constitutions in the Federal Courts*, 87 CALIF. L. REV. 1409, 1417 (1999) (articulating a "new theory" for the treatment of dual federal–state constitutional claims in the federal courts); Robert A. Schapiro, *Toward a Theory of Interactive Federalism*, 91 IOWA L. REV. 243, 249 (2005) [hereinafter Schapiro, *Interactive Federalism*] ("[A] polyphonic conception [of federalism] recognizes an important role for competition between states and the federal government.").

to bear on particular problems in administrative[21] and environmental law,[22] *Polyphonic Federalism* is, to my knowledge, the first book-length defense of a *general* practice-based theory of federalism, and the work seems certain to become canonical in the compatibilist literature. Schapiro urges that federalism doctrine—along with thinking and debate about federalism in academic, political, and popular settings—should focus not on "where to draw the line between state and federal realms, but [on] how to harness the dynamic interaction of state and federal power."[23] He provides an outstanding descriptive account of contemporary intergovernmental practices and promises to deliver the missing normative case for a compatibilist federalism doctrine.[24]

Schapiro summarizes his "polyphonic" account of federalism as follows:

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21. *See, e.g.*, MORTON GRODZINS, THE AMERICAN SYSTEM: A NEW VIEW OF GOVERNMENT IN THE UNITED STATES 75–80 (1966) (applying a cooperative federalism to the modern regulatory system); Galle & Seidenfeld, *supra* note 14, at 1985–93 (arguing that a realist view of federalism best captures administrative federalism dynamics); Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215, 283–85, 291 (2000) (arguing that the intertwined federal–state structure of the administrative state provided protection to states that rendered unnecessary the anti-commandeering doctrine established in *Printz v. United States*, 521 U.S. 898 (1997)); Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485, 1542–46 (1994) (emphasizing the interdependent, albeit unequal nature of federal–state relations in the administrative state); Gillian E. Metzger, *Administrative Law as the New Federalism*, 57 DUKE L.J. 2023, 2109 (2008) (concluding that administrative law is a promising avenue for the Supreme Court to address contemporary federalism problems).

22. *See, e.g.*, David E. Adelman & Kirsten H. Engel, *Reorienting State Climate Change Policies to Induce Technological Change*, 50 ARIZ. L. REV. 835, 838–40 (2008) (advocating a more thoughtful approach to federalism regarding federal environmental regulation); Ann E. Carlson, *Iterative Federalism and Climate Change*, 103 NW. U. L. REV. 1097, 1099 (2009) (lamenting the absence of attention to federalism in most prior analyses); John P. Dwyer, *The Practice of Federalism Under the Clean Air Act*, 54 MD. L. REV. 1183, 1185–86 (1995) (noting that federalism tends to "contract and expand" according to pragmatic concerns, but is central to Clean Air Act regulation); Kirsten H. Engel, *Harnessing the Benefits of Dynamic Federalism in Environmental Law*, 56 EMORY L.J. 159, 161 (2006) (opining that environmental issues are best addressed by a panoply of interactive or overlapping federal and state action); Garrick B. Pursley & Hannah J. Wiseman, *Local Energy*, 60 EMORY L.J. (forthcoming 2011) (manuscript at 60) (on file with Texas Law Review) ("In the context of renewable energy, we [advocate] . . . a system of federal-local collaboration in promoting distributed renewable energy technologies . . . .").

23. SCHAPIRO, *supra* note 1, at 82.

24. *See id.* at 8 ("This book . . . presents a defense of polyphonic federalism. I argue that polyphony has many advantages when compared to the alternatives, such as dualist federalism."); *see also id.* at 53 ("The rest of the book attempts to construct a legal framework for comprehending the New Federalism. As I will explain, contemporary discussions of federalism in the Supreme Court and among legal scholars often fail to take account of the character of the New Federalism."). Compatibilists focusing on particular areas may offer normative defenses specific to the context. *See, e.g.*, William W. Buzbee, *Contextual Environmental Federalism*, 14 N.Y.U. ENVTL. L.J. 108, 122–26 (2005) (detailing several benefits of the "overlapping and interactive structures that pervade current federal environmental laws," such as the opportunity for federal and state regulators to learn from each other and the reduced risk of regulatory inattention to environmental dangers). Here, I am concerned only with the possibility of the *general* normative case that Schapiro promises.

> [F]ederalism is a process that evolves over time, an ongoing relationship among various sources of power. Federalism is best understood not as a static set of power relationships, but as the dynamic output of a system in which multiple powers interact with each other. . . . Polyphony . . . shifts the focus away from dualism's concern with protecting state or federal turf. Instead, federalism is about the interaction of multiple independent voices.[25]

My goal here is to clarify and assess Schapiro's effort to build a general normative case for compatibilism. The conventionalist/compatibilist debate is central to modern theoretical literature on federalism and the constitutional structure, and its resolution—settling the constitutional legitimacy of interactive (or "polyphonic") federalism practices one way or the other—has important ramifications for all the different areas of law and policy in which interactive federalism practices operate today. Clarifying the positions and stakes will usefully advance the debate. In Part I, I situate Schapiro's view in the debate between federalism's conventionalists and compatibilists and discuss the compatibilists' shared descriptive thesis. In Part II, I attempt to identify Schapiro's normative thesis on behalf of compatibilism by evaluating several possibilities. I then briefly consider two conventionalist rejoinders and offer some concluding remarks.

I. The Descriptive Thesis

Compatibilist views have important differences that I do not wish to understate. For example, one disagreement in the literature concerns the extent to which state capacity to disagree, and perhaps even interfere, with federal policy goals is desirable within cooperative implementation schemes.[26] Compatibilists disagree about whether federal–state cooperation is uniformly desirable or varies in efficacy with the context.[27] They differ on whether local governments are also potentially valuable participants in

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25. SCHAPIRO, *supra* note 1, at 94–95.

26. *See* Bulman-Pozen & Gerken, *supra* note 7, at 1262–64 (arguing that proponents of cooperative federalism "generally argue that states should serve not as rivals or challengers to federal authority, but as faithful agents implementing federal programs"). Schapiro, Bulman-Pozen, and Gerken view state dissent as beneficial. Schapiro and some environmental federalism compatibilists stress that federal–state dialogue on policy goals and implementation strategies can improve policy outcomes—dialogue, of course, will only produce change if the participants disagree at least some of the time. *See* SCHAPIRO, *supra* note 1, at 98–104, 135–36, 168–70 ("Dialogue magnifies the value of plurality. Not only can each government try different responses to common problems, but the different regulators can learn from each other."); Carlson, *supra* note 22, at 1128–34 (noting the influence that state legislative activity has on federal environmental policy making in the context of California's approach to mobile-source greenhouse-gas emissions standards); Engel, *supra* note 22, at 170–73 (citing automobile emissions standards and brownfields legislation as resulting from federal–state interaction that led both "to adopt policy positions significantly different from the positions they would have adopted had they been regulating in a vaccum").

27. *See, e.g.*, Buzbee, *supra* note 24, at 114 (advocating a contextual approach to federalism issues in environmental law).

cooperative regulation,[28] in the extent to which they focus on administrative agencies as primary sites of policy making,[29] and in their focus on specific institutional settings as presenting particularly valuable examples of (or opportunities for) cooperation or dialogue among levels of government.[30] These internal debates are part of what makes the compatibilist-federalism literature interesting. Here, though, I want to focus on the theses that I believe Schapiro and other federalism compatibilists hold in common.

One shared thesis is the descriptive claim that contemporary federalism is, for the most part, interactive in practice. Schapiro is exceedingly persuasive in demonstrating how the image of separate federal and state "realms" of authority evaporates upon examination of how the governments actually function. His concise but rich account of the development of modern intergovernmental practices—a significant contribution to the literature in itself—starkly illustrates judicial dualism's failure to capture reality. I have no space to do it justice here, but the central theme is that the integration of economic and social life in the United States[31] in the early twentieth century made it impossible to continue trying to distinguish "national" from "local" matters in constitutional discourse, undermining a hallmark of the old dual federalism view in which the national and state governments had distinct and exclusive spheres of authority.[32] Around the time of the New Deal, policy makers and courts began to surrender the idea of separate spheres and acknowledge overlapping authority, interaction, and cooperation.[33] *Wickard v. Filburn*[34] epitomizes this transformation—there, famously, the Supreme

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28. *Compare* Nestor M. Davidson, *Cooperative Localism: Federal-Local Collaboration in an Era of State Sovereignty*, 93 VA. L. REV. 959, 965–66 (2009) ("Cooperative intergovernmental regimes have long involved not only federal-state interaction but also direct federal-local relations. This is hardly surprising, as localities are the primary site for many areas of public policy at the center of modern life."), *with* Buzbee, *supra* note 25; Carlson, *supra* note 22; Engel, *supra* note 22 (each focusing on the interaction of federal and state regulatory agencies without explicitly distinguishing the role or effect of local government actors).

29. *See, e.g.*, Galle & Seidenfeld, *supra* note 14, at 1976–77 (arguing that agencies are better suited for cultivating programmatic federalism values than state or national governments); Metzger, *supra* note 21, at 2073–76 (weighing the potential benefits and costs of a regime where federal agencies are responsible for addressing state regulatory interests).

30. Schapiro, for one, emphasizes courts—three chapters focus on intersystemic adjudication. SCHAPIRO, *supra* note 1, at 121–73.

31. *See id.* at 16–30 (describing the nationalization of U.S. politics and culture that has transcended, to a large degree, state identities). *See generally* MORRIS P. FIORINA ET AL., CULTURE WAR? THE MYTH OF A POLARIZED AMERICA (2005) (explaining that the general U.S. population is largely uniformly centrist with only a myth of polarization); Edward L. Rubin & Malcolm Feeley, *Federalism: Some Notes on a National Neurosis*, 41 UCLA L. REV. 903, 922 (1994) (noting the virtual identity of the states in political structure).

32. SCHAPIRO, *supra* note 1, at 41–45. The leading treatment of "dual federalism" is Edward S. Corwin, *The Passing of Dual Federalism*, 36 VA. L. REV. 1 (1950).

33. For a sweeping exploration of the New Deal's implications for constitutionalism, see BRUCE ACKERMAN, WE THE PEOPLE: FOUNDATIONS (1991) [hereinafter ACKERMAN, FOUNDATIONS]; BRUCE ACKERMAN, WE THE PEOPLE: TRANSFORMATIONS (1998) [hereinafter ACKERMAN, TRANSFORMATIONS].

34. 317 U.S. 111 (1942).

Court abandoned formalistic doctrinal devices for screening off local matters from the reach of the Commerce Clause and held that Congress could permissibly restrict an individual farmer's ability to grow wheat on his own land for private consumption.[35]

Policy makers today by and large appear to embrace the new interactive federalism. State and local governments increasingly cooperate with the federal government to address problems traditionally considered "national" in scope, including air quality and climate change under the Clean Air Act,[36] and water pollution under the Clean Water Act.[37] States cooperated in implementing the national Aid to Families with Dependent Children program,[38] which provided by statute that states could enact "experimental, pilot, or demonstration project[s]" designed to "promot[e] the objectives" of the program.[39] In fact, state experimentation with programs requiring aid recipients to work or actively seek jobs was an important factor in Congress's recent narrowing of federal aid along those lines.[40] State

35. *Id.* at 124–25; *see* SCHAPIRO, *supra* note 1, at 41–42 (discussing *Wickard*).

36. Clean Air Act, 42 U.S.C. §§ 7409–7410 (2006); *see* SCHAPIRO, *supra* note 1, at 119–20 (describing state and regional efforts to combat air quality problems in response to perceived federal inaction); *see also* Carlson, *supra* note 22, at 1100–01; Engel, *supra* note 22, at 166–73 (all highlighting the benefits of dynamic federal–state interaction in addressing air quality and climate change); Kirsten Engel, *State and Local Climate Change Initiatives: What Is Motivating State and Local Governments to Address a Global Problem and What Does This Say About Federalism and Environmental Law?*, 38 URB. LAW. 1015, 1026–28 (2006). There is an emerging academic consensus for the view that cooperation between the levels of government will most often be the preferable approach to allocating regulatory authority over environmental issues. *See, e.g.*, Engel, *supra* note 22, at 170–73; Pursley & Wiseman, *supra* note 22, at 31–73; Daniel B. Rodriguez, *The Role of Legal Innovation in Ecosystem Management: Perspectives from American Local Government Law*, 24 ECOLOGY L.Q. 745, 747–48 (1997); Richard B. Stewart, *States and Cities as Actors in Global Climate Regulation: Unitary vs. Plural Architectures*, 50 ARIZ. L. REV. 681, 706–07 (2008) (all noting the potential for beneficial cooperation between federal and state governments in addressing environmental problems).

37. Federal Water Pollution Control (Clean Water) Act, 33 U.S.C. §§ 1251 (2006); *see* William W. Buzbee, *Asymmetrical Regulation: Risk, Preemption, and the Floor/Ceiling Distinction*, 82 N.Y.U. L. REV. 1547, 1565–66 (2007) (characterizing state laws, regulations, and enforcement procedures as enhancing federal water pollution regulations by tailoring them to local conditions). Federal–state interaction is not always harmonious, but some argue that even discord may be beneficial. *See* Bulman-Pozen & Gerken, *supra* note 7, at 1282 (observing that states "have taken advantage of their discretion pursuant to the Clean Water Act to place conditions on, or altogether thwart, federal dam projects" to illustrate potentially productive intergovernmental discord).

38. *See* Bulman-Pozen & Gerken, *supra* note 7, at 1274 (calling the program "a classic instance of cooperative federalism"). The Aid to Families with Dependent Children Act was repealed and replaced with the Temporary Assistance to Needy Families Act. *See* Personal Responsibility and Work Opportunity Reconciliation Act of 1996 (PRWORA), Pub. L. No. 104-193, 110 Stat. 2105 (1996) (codified as amended primarily in scattered sections of 42 U.S.C.).

39. 42 U.S.C. § 1315(a) (1968).

40. *See* 42 U.S.C. § 604(f) (2006) ("A State to which a grant is made under section 603 of this title may use the grant to make payments (or provide job placement vouchers) to State-approved public and private job placement agencies that provide employment placement services to individuals who receive assistance under the State program funded under this part."); Bulman-Pozen & Gerken, *supra* note 7, at 1275–76 ("In articulating their idea of a moral society, and in

participation in cooperative regulation of immigration—perhaps the quintessential "national" subject, alongside foreign affairs[41]—is on the rise.[42] And the list could go on. Additionally, state and local governments increasingly intervene to regulate national matters unilaterally or in concert with other states and foreign actors. Climate change, again, provides examples: Schapiro cites regional initiatives in which states and cities cooperate to cut carbon dioxide emissions, including the 2001 "climate action plan" adopted by the Conference of New England Governors and Eastern Canadian Premiers.[43] Similarly, the U.S. Mayor's Climate Protection Agreement has more than 350 American cities working together toward greenhouse gas reduction goals,[44] and roughly 850 cities share information and expertise in pursuit of similar goals in the Large Cities Climate Leadership Group and the Cities for Climate Protection Campaign.[45] Corresponding to these state and local government incursions into the national sphere, the federal government now regularly intervenes to cooperate with state governments on traditionally "local" issues like education under the NCLB,[46] family law under the federal Child Support Recovery Act[47] and Parental Kidnapping Prevention Act,[48] and civil commitment of the

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putting this idea into practice by contesting federal requirements, states like Michigan and Wisconsin played a powerful role in reshaping national welfare policy. Most of their goals were realized when Congress passed the [PRWORA].").

41. *See generally* T. Alexander Aleinikoff, *Federal Regulation of Aliens and the Constitution*, 83 AM. J. INT'L L. 862 (1989) (tracing the evolution of Congress's plenary power to regulate immigration over the Constitution's first two centuries); Peter H. Schuck, *The Transformation of Immigration Law*, 84 COLUM. L. REV. 1, 1 (1984) ("[I]mmigration law remains the realm in which government authority is at the zenith, and individual entitlement is at the nadir.").

42. *See* 8 U.S.C. § 1357(g)(1) (2006) (providing that the Attorney General may allow state officers to participate in "the investigation, apprehension or detention of aliens in the United States"); Bulman-Pozen & Gerken, *supra* note 7, at 1281 (noting that states increasingly depart from federal default immigration rules); *id.* at 1281 nn.87–88 (citing examples).

43. SCHAPIRO, *supra* note 1, at 119; *see also* Engel, *supra* note 36, at 1027 (describing the Conference of New England Governors and Eastern Canadian Premiers as "on the forefront of state and local actions in the New England area").

44. JOHN BAILEY, INST. FOR LOCAL SELF-RELIANCE, LESSONS FROM THE PIONEERS: TACKLING GLOBAL WARMING AT THE LOCAL LEVEL 3 (Jan. 2007), *available at* http://www.newrules.org/sites/newrules.org/files/images/pioneers.pdf.

45. *See* Michele M. Betsill & Harriet Bulkeley, *Cities and the Multilevel Governance of Global Climate Change*, 12 GLOBAL GOVERNANCE 141, 142 (2006) (discussing the Cities for Climate Change program); *C40 Cities: An Introduction*, C40 CITIES CLIMATE LEADERSHIP GRP., http://www.c40cities.org/ (identifying a group of large cities coming together to "work together, share information and demonstrate leadership"); *Cities for Climate Protection*, ICLEI—LOC. GOV'TS FOR SUSTAINABILITY, http://iclei.org/index.php?id=10829 (discussing a pilot program targeting reduction of city emissions, undertaken by fourteen cities across the United States, Europe, and Canada).

46. SCHAPIRO, *supra* note 1, at 102–04. For more information on the NCLB, see *supra* notes 8–10 and accompanying text.

47. 18 U.S.C. § 228 (2006).

48. 28 U.S.C. § 1738A (2000); *see* SCHAPIRO, *supra* note 1, at 24 ("Congress has federalized certain interstate aspects of family disputes, particularly those pertaining to interstate . . . custody issues.").

mentally ill under statutes like the 2006 Adam Walsh Child Protection and Safety Act.[49] The federal government also involves itself in local energy policy through, for example, the Department of Energy's (DOE) "Solar America Communities" project—which, since the 1980s, has provided funding for cities to adopt renewable energy technologies[50]—and DOE's National Renewable Energy Laboratory—which provides information, technical assistance, and technology deployment support for state and local renewable energy initiatives.[51]

Less recent in origin than these boundary-blurring regulatory schemes, but perhaps even more central to Schapiro's particular account of contemporary federalism, are examples of "[i]ntersystemic adjudication, in which a court defined by one political system implements the laws of another system."[52] The extensive overlap of jurisdiction among the courts of the ostensibly "dual" American court system occasions a variety of permutations: the federal supplemental jurisdiction statute[53] allows civil rights plaintiffs, for example, to present both state and federal constitutional claims in federal court; state courts generally have jurisdiction to entertain federal law claims;[54] and, as Schapiro points out, state courts may offer broader protection for federal rights by permitting suits that would be barred by justiciability or sovereign immunity doctrines if brought in federal court.[55] State constitutions often contain rights-bearing provisions with similar wording to those in the federal Constitution, but because state courts have final interpretive authority with respect to the state provisions, they may construe state constitutions to offer broader protection for individual rights than parallel federal provisions. Thus, for example, the Georgia anti-sodomy statute that was upheld over a federal due process challenge in *Bowers v. Hardwick*[56] was struck down by a Georgia court under the similarly worded due process provision of the Georgia Constitution.[57] The state courts'

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49. Pub. L. No. 109-248, 120 Stat. 617 (2006) (codified at 18 U.S.C. § 4248 (2009)); *see* United States v. Comstock, 130 S. Ct. 1949, 1956 (2010) (affirming portions of the Act over federalism and enumerated-powers challenges).

50. *Solar America Communities*, U.S. DEP'T OF ENERGY: ENERGY EFFICIENCY & RENEWABLE ENERGY, http://www.solaramericacommunities.energy.gov/.

51. *See Applying Technologies: State and Local Activities*, NATIONAL RENEWABLE ENERGY LABORATORY, http://www.nrel.gov/applying_technologies/state_local_activities/ (providing links to resources including technical assistance, training, and clean energy policy impact).

52. SCHAPIRO, *supra* note 1, at 122.

53. 28 U.S.C. § 1367 (2006).

54. *See* Tafflin v. Levitt, 493 U.S. 455, 458 (1990) ("Under [our] system of dual sovereignty, we have consistently held that state courts have inherent authority, and are thus presumptively competent, to adjudicate claims arising under the laws of the United States.").

55. SCHAPIRO, *supra* note 1, at 152–59.

56. 478 U.S. 186 (1986), *overruled by* Lawrence v. Texas, 539 U.S. 558 (2003).

57. *See* SCHAPIRO, *supra* note 1, at 129–30 ("In the meantime, though, in *Powell v. State* in 1998, the Georgia Supreme Court ruled that the Due Process Clause of the Georgia Constitution did include a right to privacy that protected sodomy. . . . Thus, the Georgia sodomy statute did not violate the Due Process Clause of the federal Constitution, but it did violate the Due Process Clause

position eventually influenced federal law.[58] "When the United States Supreme Court revisited the issue in *Lawrence v. Texas* in 2003 and decided to overrule *Bowers*, the Court noted the intervening state court decisions as reflections of shifting social attitudes. . . . Thus, state developments served to undermine *Bowers* and to create the foundation for *Lawrence*."[59] And *Lawrence*, in turn, became a source of support for later state court decisions establishing state constitutional protections for same-sex marriage.[60] This sort of judicial cross-pollination is often overlooked,[61] but it is an important example of the complexity and benefits of federal–state interaction that Schapiro wants to emphasize: "State and federal developments intertwine[ ] and reinforce[ ] each other. The state and federal laws are independent of each other, but they exercise an important mutual influence."[62] The American dual-court system in modern practice allows each judiciary to participate in the development and enforcement of laws made by the government that constitutes the other.

These kinds of practices, which are prevalent and likely only to proliferate, thwart conceptual segmentations of the regulatory world into "national" and "local" hemispheres. Those categories, as Schapiro says, "no longer have substantial referents."[63] Nevertheless, recent Supreme Court decisions have been remarkable for their seeming resurrection of the dual federalism approach from pre-New Deal era doctrine.[64] This dualism is perhaps most visible in the Commerce Clause decisions of the Rehnquist Court's "federalist revival."[65] In *United States v. Morrison*, a dramatic

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of the Georgia Constitution." (citation omitted)). *Compare* Bowers, 478 U.S. at 191 (rejecting the notion of a federally protected "fundamental right to engage in homosexual sodomy"), *with* Powell v. State, 510 S.E.2d 18, 24 (Ga. 1998) (finding the protection of private unforced sexual behavior from governmental interference to lie "at the heart of the Georgia Constitution's protection of the right of privacy").

58. SCHAPIRO, *supra* note 1, at 100.

59. Robert A. Schapiro, *Not Old or Borrowed: The Truly New Blue Federalism*, 3 HARV. L. & POL'Y REV. 33, 44–45 (2009) (citing *Lawrence v. Texas*, 539 U.S. 558, 570–73 (2003)).

60. *See id.* at 45 ("Then *Lawrence* helped to set the stage for the state court marriage rulings in Massachusetts, California, and Connecticut. State and federal developments intertwined and reinforced each other."); *see also, e.g.*, In re Marriage Cases, 183 P.3d 384, 421 (Cal. 2008), *superseded by constitutional amendment*; Kerrigan v. Comm'r of Pub. Health, 957 A.2d 407, 465–67 (Conn. 2008); Goodridge v. Dep't of Pub. Health, 798 N.E.2d 941, 959 (Mass. 2003) (showing state supreme courts citing *Lawrence* as support for guarding against governmental incursion into private sexual practices).

61. SCHAPIRO, *supra* note 1, at 121–22.

62. Schapiro, *supra* note 59, at 45.

63. SCHAPIRO, *supra* note 1, at 55.

64. *Id.* at 54–55.

65. Vicki C. Jackson, *Federalism and the Uses and Limits of Law:* Printz *and Principle?*, 111 HARV. L. REV. 2180, 2213 (1998); *see* Ernest A. Young, *The Rehnquist Court's Two Federalisms*, 83 TEXAS L. REV. 1, 23–50 (2004) (referring, specifically, to *Lopez v. United States* and *United States v. Morrison* to demonstrate the Court's sense of its own institutional obligation to draw lines between federal enumerated powers and state sovereignty). The federalist revival also included decisions bolstering state sovereign immunity—see, e.g., *Alden v. Maine*, 527 U.S. 706, 712 (1999) (holding that the FLSA could not authorize private actions against the state of Maine in its own

example of the potential for clash between judicial dualism and interactive federalism practice, the Supreme Court struck down the civil remedy provision of the federal Violence Against Women Act after characterizing it as addressing a "noneconomic" matter.[66] The Court's concern to prevent federal intervention into the "truly local" sphere thus deprived an alleged rape victim of her only potentially effective remedy after administrative and state officials failed to provide one.[67] Other examples include Supreme Court decisions broadly construing the preemptive effect of the federal Employee Retirement Income Security Act (ERISA)[68]—this time, on the dualist presumption against state intervention into the "truly national" sphere—to preclude state-law tort suits against HMOs, once again effectively denying any remedy to injured individuals.[69] *Morrison* and the ERISA preemption cases are emblematic of the "costs" of continuing judicial dualism:

> In the name of preserving state prerogative, the Court has threatened civil rights enforcement, environmental protection, and a host of other important initiatives. State employees subject to discrimination based on age and disability may have no remedy. Congress has less authority to safeguard environmentally sensitive wetlands. Federal laws may go unenforced. At the same time, to protect an exclusive federal realm, the Court has struck down significant state regulations. The Court has applied its preemption doctrines to prevent states from providing common law remedies for harmful conduct. Under the

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courts without Maine's consent); *Seminole Tribe of Fla. v. Florida*, 517 U.S. 44, 47 (1996) (holding that the Indian Commerce Clause did not supply Congress the power to abrogate the states' Eleventh Amendment sovereign immunity)—and establishing the "anti-commandeering" rule that bars coercing state implementation of federal law—see *New York v. United States*, 505 U.S. 144, 166 (1992) (holding that "even where Congress has the authority under the Constitution to pass laws requiring or prohibiting certain acts, it lacks the power directly to compel the States to require or prohibit those acts"); *Printz v. United States*, 521 U.S. 898, 933–34 (1997) (holding that the "mandatory obligation imposed on CLEOs to perform background checks on prospective handgun purchasers plainly runs afoul of [the anti-commandeering] rule"). Notably, *Gonzales v. Raich*, 545 U.S. 1 (2005), in which the Court upheld federal criminalization of medical marijuana as a legitimate exercise of the commerce power, may signal a return to pre-*Lopez* Commerce Clause doctrine. Gil Seinfeld, *Article I, Article III, and the Limits of Enumeration*, 108 MICH. L. REV. 1389, 1403 (2010).

66. *Morrison*, 529 U.S. at 617. *See generally* Judith Resnik, *Categorical Federalism: Jurisdiction, Gender, and the Globe*, 111 YALE L.J. 619, 626–29 (2001) (criticizing the *Morrison* Court for having "equated a complex set of legal regulations with the categories of family and crime, located those categories as subject to state governance, insisted on the naturalness of the division, and assumed the federal/state options to be bipolar and exclusive").

67. *See* SCHAPIRO, *supra* note 1, at 101 (describing how the *Morrison* Court's interpretation of federalism foreclosed VAWA as a potential "avenue of relief" for the alleged rape victim).

68. Employee Retirement Income Security Act of 1974, 29 U.S.C. §§ 1001–1461 (2006).

69. *See* Aetna Health, Inc. v. Davila, 542 U.S. 200, 214 (2004) (holding that the respondents' claims against their HMOs pursuant to the Texas Health Care Liability Act were preempted by ERISA); Pegram v. Herdrich, 530 U.S. 211, 237 (2000) (declining to allow a breach of fiduciary duty claim under ERISA for injuries caused by a doctor's malpractice, on the grounds that doing so would essentially create a federal claim that would inadvertently preempt state malpractice law); *see also* Schapiro, *supra* note 59, at 46–47 ("ERISA preemption generally does not substitute a federal remedy for state relief, but rather eliminates any meaningful remedy for the plaintiff.").

> dormant Commerce Clause, the Court has invalidated state efforts to address local problems, such as waste disposal. The Court's dualist approach has narrowed the scope of both federal and state authority in important areas.[70]

The reality of interactive or "polyphonic" federalism in practice and the tension between such arrangements and the dualism that still pervades judicial federalism doctrine are undeniable. Schapiro proposes that the prevalence of nondualist federalism arrangements legitimately calls for doctrinal revision. But what, exactly, is the argument for the legitimacy of an alternative federalism doctrine largely—perhaps entirely—determined by reference to practical realities? In the next section, after some theoretical foregrounding, I assess possible formulations of Schapiro's normative claim on behalf of the compatibilists.

II. The Normative Thesis

Generally speaking, the core compatibilist idea that actual governance practices should inform judicial rules on the legitimacy of those practices is not new—in the separation-of-powers context, it is most often called functionalism.[71] The question in every context, though, is: What is the *appropriate* relationship of practice to constitutional doctrine? Must doctrine always be drawn from insulated constitutional interpretation—so-called *Marbury*-shielded constitutional exegesis[72]—even if the result of the interpretive effort is a rule that would invalidate entire categories of action that, in practice, make governance more effective, more efficient, more democratically accountable, or more just? Conventionalists likely would contend that at least part of the process of constitutional adjudication should be uninfluenced, or at least not primarily influenced, by pragmatic concerns. So far, compatibilist accounts of federalism have not directly answered the deep question, presented by their proposition that doctrine should be reconciled with practice: How may that legitimately be done?

This is no small omission. In the separation-of-powers context, the question occupied the courts for years. Conventionalism and compatibilism (or functionalism) clashed over the expansion of the administrative state during and after the New Deal.[73] Agencies, creatures primarily of the

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70. SCHAPIRO, *supra* note 1, at 57 (footnotes omitted).

71. *See, e.g.*, Jacob E. Gersen, *Unbundled Powers*, 96 VA. L. REV. 301, 355 (2010) (noting that functionalists focus on whether a change will disrupt the balance of powers between the branches of government); M. Elizabeth Magill, *The Real Separation in Separation of Powers Law*, 86 VA. L. REV. 1127, 1143 (2000) (describing functionalism as being "constrained by . . . the 'reality of the existing government'"); *cf.* Benjamin & Young, *supra* note 12, at 2129 (discussing functionalist administrative federalism views).

72. Henry P. Monaghan, *The Supreme Court, 1974 Term—Foreword: Constitutional Common Law*, 89 HARV. L. REV. 1, 31 (1975).

73. Gary Lawson remains a strong voice for the conventionalist view in this area, though even he would probably concede that the war was won by the compatibilists. *See* Lawson, *supra* note 12,

Executive, seemed increasingly to wield both legislative and judicial power in direct derogation of traditional separation-of-powers norms. The battle raged for a time, but the compatibilists eventually prevailed—the administrative state is here to stay. Judicial enforcement of the constitutional prohibition on delegations of legislative power to noncongressional actors receded to the substantially laxer requirement that Congress provide some "intelligible principle" to guide agency discretion.[74] A similar progression occurred with respect to non-judicial exercises of adjudicatory power: Although conventionalism resurfaced momentarily when a plurality of the Supreme Court struck down the non-Article III federal bankruptcy courts on separation-of-powers grounds,[75] compatibilism reasserted itself, and administrative courts are now subject to a permissive constitutional standard.[76] There is still the occasional conventionalist moment in separation-of-powers jurisprudence—the Court in *INS v. Chadha*, for example, invalidated hundreds of federal legislative veto provisions despite widespread acknowledgement of their practical utility.[77] But, generally, constitutional doctrine has *changed* to accommodate the realities of the modern administrative state. The normative case for that compatibilist transformation involves, on one influential account, a grand hypothesis that the New Deal era actually altered the *meaning* of the Constitution outside the formal Article V amendment process.[78] If that is correct, then judicial doctrine that permits broad agency authority may be justified as a means of implementing the informal constitutional amendment(s) that ratify the administrative state.

This is an elegant solution, but theories of informal constitutional change are deeply controversial. A powerful criticism is that it is difficult to understand how a court should determine the precise content of an unwritten

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at 1232 (arguing that much of the modern administrative state is unconstitutional, but acknowledging that it is now essentially unchallenged).

74. *Compare* A.L.A. Schechter Poultry Corp. v. United States, 295 U.S. 495, 529–30 (1935) (analyzing whether Congress had impermissibly delegated its "essential legislative function"), *and* Panama Refining Co. v. Ryan, 293 U.S. 388, 430 (1935) (invalidating § 9 of the National Industrial Recovery Act on the ground that Congress provided no limits on the use of delegated power), *with* Whitman v. Am. Trucking Ass'ns, 531 U.S. 457, 474–75 (2001) (noting that the Court had never found the required "intelligible principle" lacking except in *Schechter* and *Ryan* and has generally accorded Congress great discretion in delegating power to federal agencies). *See generally* Cass R. Sunstein, *Nondelegation Canons*, 67 U. CHI. L. REV. 315 (2000) (describing the development of modern nondelegation doctrine).

75. *See* Northern Pipeline Constr. Co. v. Marathon Pipe Line Co., 458 U.S. 50, 84–87 (1982) (holding that the Bankruptcy Act of 1978 resulted in an unconstitutional encroachment on the federal judicial power).

76. *See generally* Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833 (1986).

77. *See* INS v. Chadha, 462 U.S. 919, 958–59 (1983) ("In purely practical terms, it is obviously easier for action to be taken by one House without submission to the President; but it is crystal clear . . . that the Framers ranked other values higher than efficiency.").

78. *See* ACKERMAN, TRANSFORMATIONS, *supra* note 33, at 259–61 (criticizing the contemporary understanding of the New Deal revolution as a mere rediscovery of the Marshall-era constitutional transformation).

constitutional amendment.[79] The alternative to the informal amendment account is to argue that our legal officials permissibly have accepted "a set of awkward but durable intellectual compromises," that is to say, "that these agencies would not supplant Congress or act on their own and judicial review would keep the agencies within their statutory bounds. Congress would still make the decision of how much authority to give to agencies, so the buck would stop there."[80] This reconciliation of separation-of-powers norms with the realities of modern administrative practice is perhaps less capacious than the idea of an informal constitutional amendment. But it is widely accepted, such that "the basic legitimacy of the administrative state is no longer in doubt, practically speaking . . . ."[81]

Schapiro proposes to reconcile constitutional federalism principles with modern practice, and, as with the case of the administrative state, the formulation of the conciliatory argument has implications for its persuasiveness. I examine several possibilities in the remainder of this Section.

A. Constitutional Doctrine and Instrumental Reasoning

We need to begin with a few theoretical observations. Constitutional adjudication traditionally has been viewed as comprised of two steps: first, constitutional interpretation and second, application of the relevant constitutional requirement, as interpreted, to the facts of the case.[82] Recent work in constitutional theory, however, demonstrates that this two-step model oversimplifies the process.[83] For a more accurate picture, we must distinguish

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79. *See* L.A. Powe, Jr., *Ackermania or Uncomfortable Truths?*, 15 CONST. COMMENT. 547, 566–67 (1998) (reviewing ACKERMAN, TRANSFORMATIONS, *supra* note 32) (discussing the difficulty of interpreting the New Deal "amendments" without explicit text); Suzanna Sherry, *The Ghost of Liberalism Past*, 105 HARV. L. REV. 918, 919–20 (1992) (reviewing BRUCE ACKERMAN, WE THE PEOPLE (1991)) (discussing the challenge of constitutional synthesis for modern judges as compared to those before the New Deal); Ernest A. Young, *The Constitution Outside the Constitution*, 117 YALE L.J. 408, 457 (2007) (highlighting the "rule of recognition problem" as a common critique of alternative theories of constitutional change).

80. Benjamin & Young, *supra* note 12, at 2142–43 (citation omitted); *see also* CASS R. SUNSTEIN, AFTER THE RIGHTS REVOLUTION: RECONCEIVING THE REGULATORY STATE 143 (1990) ("Broad delegations of power to regulatory agencies . . . have been allowed largely on the assumption that courts would be available to ensure agency fidelity to whatever statutory directives have been issued.").

81. Benjamin & Young, *supra* note 12, at 2144; *see also id.* (noting that important administrative federalism questions remain unsettled).

82. Mitchell N. Berman, *Constitutional Decision Rules*, 90 VA. L. REV. 1, 32–33 (2004).

83. *See generally* Berman, *supra* note 82, at 4–6 (providing academic examples of constitutional doctrine conceived as a category of judicial work product). Berman divides the debate into camps: "'Taxonomists' . . . advocate something like the 'complex' model of constitutional adjudication [while] 'Pragmatists' . . . insist that constitutional adjudication is instrumental 'all the way up.'" *Id.* at 50. For examples of the taxonomic approach, see Richard H. Fallon, Jr., *The Supreme Court, 1996 Term—Foreword: Implementing the Constitution*, 111 HARV. L. REV. 54 (1997); Monaghan, *supra* note 72; Lawrence Gene Sager, *Fair Measure: The Legal Status of Underenforced Constitutional Norms*, 91 HARV. L. REV. 1212 (1978). For examples of the pragmatist approach, see Daryl J. Levinson, *Rights Essentialism and Remedial Equilibration*, 99

constitutional meaning from constitutional doctrine and distinguish between two kinds of constitutional doctrine.

The distinction between meaning and doctrine is fairly intuitive; Schapiro describes it as a "conceptual space between a constitution and what the court says it means."[84] The process of applying various interpretive methodologies to derive a meaning for the constitutional text is what we commonly call constitutional interpretation. The product of that process in courts is a statement of "judge-interpreted constitutional meaning"—what Professor Berman would call a "constitutional operative proposition."[85] These interpretive statements are a kind of *doctrine* because they are court-announced—they state what a majority of the court believes the Constitution means or requires, properly interpreted.[86] This is distinct from constitutional meaning in the sense of "correct," "best," "incontestable," or "universally accepted" meaning.[87] Regardless of the court's preferred interpretation, there is usually a plausible counter-interpretation to provide grist for further interpretive debate. Judges are fallible; they may make mistakes in interpreting the Constitution. We can make sense of claims that the court got an interpretive question wrong precisely because the Constitution does not simply mean whatever a court says that it means.[88]

The distinction among *kinds* of constitutional doctrine is less obvious but even more important for present purposes. It is expressed in the "two-output thesis": the "claim 'that there exists a conceptual distinction between two sorts of judicial work product each of which is integral to the functioning of constitutional adjudication,' namely judge-interpreted constitutional meaning and judge-crafted tests bearing an instrumental relationship to that meaning."[89] These tests are the rules and standards by which courts determine whether conduct falls within the meaning of a constitutional prohibition or permission and are distinct from court-announced propositions of

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COLUM. L. REV. 857 (1999); David A. Strauss, *The Ubiquity of Prophylactic Rules*, 55 U. CHI. L. REV. 190 (1988).

84. SCHAPIRO, *supra* note 1, at 148.

85. Berman, *supra* note 82, at 8, 58; Mitchell N. Berman, Guillen *and Gullibility: Piercing the Surface of Commerce Clause Doctrine*, 89 IOWA L. REV. 1487, 1520–22 (2004) (discussing the process by which courts apply constitutional doctrine and meaning).

86. Berman, *supra* note 85, at 1519–20; *see* Mitchell N. Berman, *Aspirational Rights and the Two-Output Thesis*, 119 HARV. L. REV. F. 220, 220 (2006) ("'[T]he Court often must craft doctrine that is driven by the Constitution, but does not reflect the Constitution's meaning precisely.'" (quoting Fallon, *supra* note 83, at 57)).

87. Berman, *supra* note 86, at 220 (discussing Constitutional operative propositions in Commerce Clause jurisprudence); Berman, *supra* note 85, at 1519–20.

88. *See* Kermit Roosevelt III, *Constitutional Calcification: How the Law Becomes What the Court Does*, 91 VA. L. REV. 1649, 1661 (2005) (discussing interpretive error). Schapiro notes that the meaning/doctrine distinction also helps us understand the possibility of dialogue between federal and state courts on interpretive questions, which may enhance interpretive outcomes overall. SCHAPIRO, *supra* note 1, at 147–49.

89. Berman, *supra* note 86, at 220 (quoting Berman, *supra* note 83, at 36) (citation omitted).

constitutional meaning.[90] A default decision rule is the preponderance-of-the-evidence standard, which instructs a court to conclude that a law is unconstitutional if convinced that, more likely than not, the Constitution is violated. This comes closest to straightforward implementation of a proposition of interpreted constitutional meaning on a case-by-case basis.

But many of these tests and standards of constitutional doctrine—for brevity, call these constitutional "decision rules," following Professor Berman—differ from the preponderance standard and, thus, from case-by-case judicial assessment of whether the underlying constitutional requirement, as interpreted, more likely than not has been violated.[91] Typically, decision rules that deviate from the preponderance standard are adopted in response to instrumental concerns relevant to the process of constitutional adjudication, such as the concern to reduce adjudicatory error. To lower the judicial error rate, decision rules might incorporate a *proxy*, e.g., an inquiry into whether a discriminatory law serves a "compelling state interest," to substitute for a harder constitutional question, like: "Does this law deny equal protection?" or, perhaps, "Was this legislation motivated by racial animus?" Burdensome factual inquiries—into actual legislative purposes, for example—might be avoided by adopting decision rules that require courts to presume the presence or absence of illicit purpose under certain circumstances.[92] Other purposes of constitutional adjudication—protecting rights, providing notice to governmental actors of their duties, settling disputes, etc.—may give rise to other instrumental reasons that justify adopting decision rules other than the preponderance standard.[93]

There is some controversy about whether statements of interpreted constitutional meaning must—or even possibly could—be formulated without reference to instrumental considerations.[94] The "pragmatists" in this debate argue that the process of constitutional adjudication accounts for instrumental concerns "all the way up" to the formulation of interpretive

90. *See* Berman, *supra* note 82, at 32–35 (explaining that judge-made tests of constitutionality are not best understood as products of constitutional interpretation alone).

91. *See* Berman, *supra* note 85, at 1522–23 (giving examples to support the belief that many constitutional doctrines are best conceived of as "non-standard decision rules" different from the preponderance standard); Roosevelt, *supra* note 88, at 1658 (exploring reasons why the Court might choose decision rules that differ significantly from the simple question of whether the constitutional requirement as interpreted has been violated).

92. *See* Berman, *supra* note 82, at 67 (noting that the Court employs decision rules incorporating conclusive presumptions when it believes that the improper motivation of a government actor would be too difficult to prove); Roosevelt, *supra* note 88, at 1665–67 (suggesting that courts might avoid burdensome enforcement costs by substituting an objective decision rule for an inquiry into subjective legislative motivations such as personal hostility).

93. *See* Berman, *supra* note 82, at 85–89 (canvassing a variety of non-standard constitutional decision rules and examining their rationales).

94. *See id.* at 45–50 (relaying the arguments of other scholars that there is no actual distinction between constitutional meanings and constitutional rules because all interpretation involves pragmatic considerations).

statements of constitutional meaning;[95] others insist that the interpretive part of constitutional doctrine must be free from the impurity of pragmatic calculation.[96] My purposes here, however, require only that we distinguish interpretive statements of constitutional meaning from decision rules and accept the relatively uncontroversial proposition that *decision rules* legitimately may be influenced by instrumental considerations. The two-output thesis, understood this way, is widely accepted.[97] One important implication of this view is the possibility of judicial "underenforcement"[98] or "overenforcement"[99] of constitutional requirements. Put simply, the instrumental considerations relevant in some adjudicatory contexts support decision rules that prohibit less or more conduct than does the underlying constitutional requirement itself, properly construed. An example of *underenforcement* is the rational basis standard, which, in a variety of contexts, results in courts frequently upholding actions that in fact violate the underlying constitutional requirements.[100] Importantly, the underlying constitutional requirements, even when underenforced by courts, remain binding on all government officials "to their full conceptual limits"[101]—thus, for example, Congress is obligated to comply with the *full* equal protection requirement even if that requires more than is needed to satisfy the rational basis review standard.

Although Schapiro does not address them explicitly, both his critique of dualist federalism doctrine and defense of intersystemic adjudication suggest

95. *See, e.g.*, Levinson, *supra* note 83, at 873 ("[C]onstitutional adjudication is functional not just at the level of remedies, but all the way up."); Strauss, *supra* note 83, at 207 ("[I]n deciding constitutional cases, the courts constantly consider institutional capacities and propensities."). For this reason, some pragmatists deny the utility of distinguishing interpretive from functional judicial work product. Berman, *supra* note 82, at 45–46.

96. *See* Berman, *supra* note 82, at 44–48 (describing criticism of the "rights essentialism" belief that constitutional rights have an ideal form detached from pragmatic concerns).

97. *See id.* at 116 (identifying a constitutional operative proposition and a decision rule in the *Miranda* doctrine); Lawrence Gene Sager, *Foreword: State Courts and the Strategic Space Between the Norms and Rules of Constitutional Law*, 63 TEXAS L. REV. 959, 959–62 (1985) (discussing the freedom of state courts to interpret their state constitutions without regard to federal precedential rules as long as that interpretation does not conflict with federal constitutional norms).

98. *See* Sager, *supra* note 83, 1213–20 (positing the underenforcement thesis, which asserts that courts sometimes underenforce constitutional norms for practical reasons, including concerns about competence and federalism).

99. *See* Monaghan, *supra* note 72, at 3–6, 45 (discussing Due Process and Equal Protection doctrines that arguably invalidate more conduct than violates the underlying constitutional right, properly construed).

100. *See* Roosevelt, *supra* note 88, at 1661 (arguing that the rational basis test is an example of how the Court underenforces a constitutional norm by "uphold[ing] violations but strik[ing] down almost no valid acts."); *see also* Berman, *supra* note 82, at 80–82 n.253 (arguing that there are alternative, "jusitificatory," and "evidentiary" reasons for the manner in which the Equal Protection Clause is actually enforced short of its full formal breadth); Sager, *supra* note 83, at 1217–18 (describing the propriety and capacity reasons for the Supreme Court's underenforcement of the Equal Protection Clause).

101. Sager, *supra* note 83, at 1221.

that he accepts these distinctions.[102] We should keep them in mind as we consider the compatibilist normative claims that may be advanced in *Polyphonic Federalism.* There seem to be at least three possibilities: Schapiro's could be a claim that courts, commentators, Congress, and everyone else should change the focus, language, and conceptual categories used in discussing and making decisions about federalism. Alternatively, his claim might be that the Constitution, properly interpreted, *mandates* the polyphonic view rather than the dualist view. Or, he may intend to claim that different decision rules should apply to decisions about federalism in the light of instrumental considerations. These claims are not necessarily mutually exclusive; I discuss them in turn in the next section.

B. Assessing Compatibilists' Potential Normative Claims

Schapiro's core normative claim seems to be expressed in the following passage:

> In the polyphonic conception, federalism is characterized by the existence of multiple, independent sources of political authority. The scope of this political authority is not defined by subject matter. No kind of conduct is categorically beyond the boundaries of state or federal jurisdiction; the federal and state governments function as alternative centers of power. In the first instance, any matter is presumptively within the authority of the federal government and of a state government. *Full concurrent power is the norm.* A polyphonic conception of federalism thus resists the idea of defining enclaves of state power protected from federal intrusion.[103]

The central task for "an overall theory of normative federalism,"[104] in Schapiro's view, is "manag[ing] the vast realms of concurrent state and federal authority."[105] Courts should consider the values that federalism promotes—both the "traditional federalism values of responsiveness, self-governance, and liberty"[106] and the *new* polyphonic values of plurality, dialogue, and redundancy that Schapiro identifies by observing modern practice.[107]

Importantly, arguments about the capacity of federalism to promote these values are *instrumental* arguments—federalist government structures and practices are desirable not in themselves, but because they promote responsiveness, self-government, liberty, plurality, dialogue, redundancy, and

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102. *See* SCHAPIRO, *supra* note 1, at 62–63, 136–37, 147–50 (analyzing the dualist approach—distinguishing the "truly local" from the "truly national"—and defending the legitimacy of intersystemic adjudication).

103. *Id.* at 95 (emphasis added).

104. *Id.* at 72.

105. *Id.* at 73.

106. *Id.* at 177.

107. *Id.* at 97–98.

other valuable qualities of government.[108] Promoting those governmental qualities, in turn, furthers the more fundamental goals of ensuring that the government functions effectively, endures through time, makes good policy, and provides citizens with the opportunity to live at least minimally decent lives. Plurality, or "the possibility of multiple approaches to a particular problem," Schapiro explains, enhances the government's capacity to resolve complex problems in an increasingly complex world.[109] "Dialogue" between federal and state government officials and institutions "magnifies the value of plurality" by allowing "different regulators [to] learn from each other" and by "facilitat[ing] regulatory innovation."[110] Finally, "[r]edundancy makes systems both more resilient and more innovative" by providing "alternative forms of relief" and "a fail-safe mechanism" to provide remedies in the event that "one or the other government should fail to offer adequate safeguards."[111] Determining whether an action or arrangement promotes one or more of these federalism values is a proxy—a heuristic or simplifying rule of thumb—that substitutes for the harder constitutional question of whether the action is consistent with the broad ends of good government.

The extent to which governmental arrangements will promote these sorts of goals will vary with the arrangement and the context. Thus, "[t]he challenge for a polyphonic account of federalism," Schapiro explains, "is how and when to promote the values of plurality, dialogue, and redundancy without undermining important concerns for uniformity, finality, and hierarchical accountability."[112] He does not downplay the importance of values like uniformity and finality in ensuring that government functions effectively; he admits that in certain contexts these considerations will outweigh the benefits of plurality and dialogue for the promotion of broader goals.[113] Unilateral action by one level of government, protected from disruption by the other, sometimes will be optimal. But Schapiro argues that decision making about federalism will be enhanced on net if decision makers directly balance the benefits and costs of permitting polyphonic practices. Current efforts to separate spheres of federal and state power, by contrast, are counterproductive. The separate spheres inquiry itself is a doctrinal proxy, substituting for the underlying question of the action's capacity to promote governance values. Questions about whether federal regulation enacted pursuant to the Commerce Clause undermines federalism values may be very

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108. *See* Barry Friedman, *Valuing Federalism*, 82 MINN. L. REV. 317, 378–412 (1997) (hypothesizing that federalism might matter for a number of reasons including accountability, liberty, diversity, experimentation in governance, citizen participation in democracy, and public health and welfare); Young, *supra* note 13, at 1764, 1844–48 (describing the traditional federalism values as "*functional* values" (emphasis added)).

109. SCHAPIRO, *supra* note 1, at 98.

110. *Id.* at 98–99.

111. *Id.* at 101.

112. *Id.* at 103.

113. *Id.* at 101–04, 141–42.

difficult to answer. To reduce the potential for adjudicatory error, courts might adopt a proxy like the "commercial/noncommercial" distinction from *Lopez* to substitute for the underlying inquiry if it is reasonable to think that federal regulation of noncommercial matters will undermine good government values much of the time. Schapiro argues that the assumption supporting the commercial/noncommercial distinction and similar assumptions he ascribes to dualists have been rendered unreasonable by changing realities of governance since the New Deal; thus he rejects the commercial/noncommercial distinction along with other "second order" proxies for federalism values—and insists that, most of the time, better results will come from directly engaging the values of federalism. That task "may be difficult, but the polyphonic account at least *identifies the proper values* for managing the overlap of federal and state power."[114]

Schapiro is exceedingly clear on what he wants courts (and everyone else) to *think and talk about* when making decisions about federalism. He is less clear on exactly what kind of normative claim this directive amounts to. The answer makes a difference for the legitimacy of the proposal.

He may mean to advance the modest claim that courts, Congress, administrators, commentators, and everyone else should give greater consideration to the way that today's complex intergovernmental interactions generate plurality, dialogue, and redundancy in government and to the capacity of plurality, dialogue, and redundancy to advance broader governance goals when debating or making decisions about federalism. This claim is modest because it simply calls attention to underappreciated features of existing practices. At times, Schapiro is at pains to do just that. For example, he observes that "[t]he existence of parallel state and federal court systems provides a crucial alternative means for the enforcement of federal or state rights"—a statement about the status quo—and says that "[t]he polyphonic conception of federalism *emphasizes* that possibility."[115] Schapiro's detailed explication of the plurality, dialogue, and redundancy that characterize modern intergovernmental regimes and his explanation of how these features promote efficacy, responsiveness, and rights protection in government are important contributions to the literature. He provides a new language of value with which to understand and discuss particular virtues of contemporary practices. In this sense, as Schapiro recognizes, "polyphonic federalism is," in part, "an account of the status quo."[116]

But this cannot be Schapiro's only normative claim because it is very nearly non-normative. The only change required is a slight alteration of the way that people think about existing intergovernmental practices. If one also holds the view that doctrinal settlement usefully promotes notice, predictability, and other rule-of-law values that should be weighted equally

114. *Id.* at 103 (emphasis added).
115. *Id.* at 156 (emphasis added).
116. *Id.* at 8.

with or more heavily than federalism's governance values, then one might, even after paying heightened attention to the benefits of the innovative federalism arrangements that Schapiro emphasizes, conclude that existing dualist doctrine should remain unchanged. Schapiro clearly has a more normative ambition than that. The persistence of judicial decisions like *Morrison* and the ERISA preemption cases[117] demonstrates that a "reconceptualization" of federalism[118] alone will not reconcile practice with doctrine. Dualism may result from wrong thinking about federalism, but the tension between dualism and modern practice is not resolvable solely by correcting our thinking. It is physically embodied in dualist judicial decisions that have precedential force. Doctrine must be revised and, indeed, Schapiro suggests some particular revisions. He wants to abandon the "obstacle" preemption doctrine—under which state laws that are neither expressly preempted nor in direct conflict with a federal law may nevertheless be invalidated for impeding federal policy goals—because it often undermines the kind of cooperative intersystemic dialogue and feedback that spark beneficial regulatory innovation.[119] He also wants to decrease the frequency of judicial interventions to protect state policy-making autonomy—as in the dualist Commerce Clause cases—because they tend to nullify beneficial remedial redundancies and block federal efforts to engage with states in cooperative regulation of "local" matters.[120] It seems that he must offer more than just a new language of value for discussing federalism—he does provide that, but he also argues that polyphonic values should be accorded sufficient *weight* in constitutional adjudication to motivate doctrinal revision. The polyphonic values are not just "the proper values";[121] they are also the values to which courts should assign the greatest weight, and perhaps consider as determinative, in formulating federalism doctrine.

One way that polyphonic values might legitimately influence federalism doctrine is if they tell us something about the correct interpretation of relevant constitutional provisions. That is, Schapiro might be advancing a claim about constitutional *meaning*—that the Constitution, properly interpreted, requires polyphonic federalism rather than dualism because it *mandates* plenary, overlapping, state and federal regulatory authority rather than distinct spheres of non-overlapping authority. In places, Schapiro writes as though this is the sort of claim he wants to press. For example, he characterizes judicial dualism as both "a conception of constitutional

117. *See supra* notes 65–69 and accompanying text.

118. SCHAPIRO, *supra* note 1, at 7.

119. *Id.* at 105; *see* Hines v. Davidowitz, 312 U.S. 52, 67 (1941) (determining whether the law in question "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress"). *See generally* Garrick B. Pursley, *Preemption in Congress*, 71 OHIO ST. L.J. 511, 515, 520–24 (2010) (canvassing the varieties of preemption doctrine and discussing "obstacle" preemption).

120. SCHAPIRO, *supra* note 1, at 111.

121. *Id.* at 103.

federalism" and "a concomitant theory of the judicial role."[122] For dualists, "[f]ederalism means some firm limitation on federal power, and the way courts enforce that kind of concept is by drawing lines such as commercial/noncommercial."[123] Schapiro thus seems to criticize dualism as assuming, incorrectly, that proper *interpretation* of the Constitution mandates that federal power be limited to "truly national" matters and that state power be limited to "truly local" subjects. On this view, the commercial/noncommercial test set out in *Lopez* more or less directly enforces a federalism-based limitation on the commerce power. If dualism depends upon a particular interpretation of relevant constitutional provisions, then Schapiro's view—which he describes as an "alternative to dualist federalism"[124]—might be premised on a different interpretation that requires different implementing rules.

There are several problems with this kind of claim that make me reluctant to attribute it to Schapiro. The polyphonic interpretive claim as I have formulated it does not immediately call to mind any particular constitutional provision, and for good reason: Schapiro does not tether his normative claim to any particular provision. This is reconcilable with the idea that his claim is interpretive if Schapiro's account relies upon a claim that there has been informal constitutional change ratifying interactive federalism practices. This would make his account similar to some compatibilist attempts to reconcile the Constitution with the administrative state.[125] He does not articulate or defend such a claim, however, and it is not obvious that such informal constitutional change has occurred, so I doubt that this is the basis for his account. And that is a good thing for the federalism compatibilists' cause. Theories of informal constitutional change are, as I noted, controversial,[126] and, generally speaking, the fewer theoretical controversies a normative claim invokes, the more persuasive it is.

More likely, Schapiro spends little time parsing constitutional text because the Constitution's broad structural norms entrenching the separation of powers and federalism are not communicated directly by any single textual provision. There are "several clauses with important federalism implications"—the Tenth and Eleventh Amendments leap to mind here—"but no central 'Federalism Clause'" in the Constitution.[127] Instead broad federalism and separation-of-powers norms are *inferred* from the government structure established by other provisions. Yes, Schapiro focuses his critique of dualism on the *Lopez* Court's commercial/noncommercial distinction,

122. *Id.* at 62.

123. *Id.*

124. *Id.* at 85.

125. *See supra* notes 72–77 and accompanying text.

126. *See supra* note 79 and accompanying text.

127. Ernest A. Young, *State Sovereign Immunity and the Future of Federalism*, 1999 SUP. CT. REV. 1, 36 (1999).

which is about constraints on the federal commerce power. But there are two categories of such constraints—internal and external—and only the former arise from the text of the Commerce Clause. The commerce power is constrained in principle by the terms of the textual grant, but Schapiro and the Rehnquist Court are more concerned with federalism-based constraints external to the Clause. Polyphonic federalism, Schapiro argues, "reli[es] on structural inferences from the Constitution," and in this sense "differs little from dualism."[128] Perhaps, then, his claim is that when we infer a basic federalism norm from the constitutional structure, polyphonic federalism is the correct inference, or at least a better inference than dualism.

This argument, too, is problematic enough to doubt that Schapiro means to press it. Structural inference is a form of constitutional interpretation; thus, claims that one inference is preferable to another should be based on reasons that flow from an interpretive methodology. Choosing an interpretive methodology requires engaging debates about the relative merits of different approaches. Schapiro does not articulate or defend any particular interpretive method. Some passages seem to evoke "living constitutionalism"—e.g., his claim that federalism is "the dynamic output of a system" that "unfolds over time."[129] But "living constitutionalism" is a *category* of interpretive theories,[130] and Schapiro neither claims to accept any one of these views nor provides the kind of systematic analysis of the Constitution's structural provisions that would be required to derive a polyphonic federalism norm as a matter of interpretive inference. The Constitution's structural provisions by themselves supply so little content for federalism norms that, without substantially more interpretive work than Schapiro undertakes, dualism and polyphonic federalism both seem at first blush to be permissible and, perhaps, equally plausible structural inferences.

Even without a specific interpretive theory, however, one may still infer basic federalism norms from the bare constitutional text and a basic understanding of the general purposes of constitutions. The text clearly presupposes that there will be both federal and state governments—it mentions the states in more than fifty separate provisions.[131] And, without knowing anything about Framing-Era intentions or understandings, abstract moral theory, or any other conventional source of interpretive evidence, we know as a definitional matter that constitutions are supposed to constitute functional governments that endure through time. From these observations, we can derive a general federalism norm that likely would be acceptable to

128. SCHAPIRO, *supra* note 1, at 109.

129. *Id.* at 95.

130. *See generally* Mitchell N. Berman, *Originalism is Bunk*, 84 N.Y.U. L. REV. 1, 56 (2009) (discussing "living constitutionalism" as a category term for a collection of different theories of constitutional interpretation).

131. *See* Garrick B. Pursley, Dormancy 18 & n.98 (unpublished manuscript) (on file with Texas Law Review) (listing these).

proponents of nearly every interpretive theory:[132] The Constitution requires that there be both federal and state governments and that the overall system of government function well and endure.[133] Schapiro hints that this basic norm is, in fact, the constitutional requirement at the core of his view—while "the allocation of authority between the states and the national government . . . differs between the polyphonic and dualist approaches," he explains, "the constitutional recognition of independent state and federal authority remains."[134] "What receives constitutional protection," he notes, "is the overall system."[135]

This provides additional reason to doubt that Schapiro is advancing a claim about constitutional meaning. The polyphonic view's presumption of plenary federal power is obviously in tension with the notion, central in constitutional discourse and (at least historical) practice, that the federal government has limited, enumerated powers.[136] But it is also in tension with the basic federalism norm that we have derived. For the system to endure over time, both levels of government must be precluded from undermining it. Thus, "[t]he anti-commandeering doctrine," Schapiro acknowledges, "does recognize an important element of federalism. The federal government would violate constitutional principles of federalism if it assumed control over the state governmental process."[137] And, as I discuss elsewhere at length, state government actions that undermine the constitutional structure should be similarly precluded by implication; "dormancy" doctrines applied in the interstate commerce, admiralty, and foreign affairs contexts seem to implement that implied preclusion.[138] But truly *plenary* state and federal power would include authority to take actions that undermine the constitutional structure. Since everyone agrees that the Constitution should not be construed to contain internal inconsistencies, we should not read Schapiro as

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132. The potential exception here is strict textualism, a theory of interpretation that may deny the legitimacy of inferring norms from the constitutional text in general. *See* John F. Manning, *Clear Statement Rules and the Constitution*, 110 COLUM. L. REV. 399, 404–06 (2010) ("Textualism rests centrally upon the idea that all enacted texts, including the Constitution, entail compromise, which inevitably involves difference-splitting decisions about how far and in what ways to carry a value into effect."); John F. Manning, *Federalism and the Generality Problem in Constitutional Interpretation*, 122 HARV. L. REV. 2003, 2039–40 (2009) ("[P]roponents of the 'living Constitution' ideal . . . disregard[] an important reality of the constitutionmaking process . . . ."); Pursley, *supra* note 131, at 31–34 (offering responses to the strict textualist critique of structural inference).

133. *See id.* at 13–19 (describing the constitutional structure in detail and deriving the basic requirements of efficacy and durability by inference).

134. SCHAPIRO, *supra* note 1, at 96.

135. *Id.*

136. *See* New York v. United States, 505 U.S. 144, 156 (1992) (reasoning that a basic understanding of the Tenth Amendment and constitutional structure reveals that *some* powers are "not conferred" on the federal government and, therefore, are "withheld" for the states); United States v. Darby, 312 U.S. 100, 123–24 (1941) ("The [Tenth] amendment states but a truism that all is retained which has not been surrendered.").

137. SCHAPIRO, *supra* note 1, at 96.

138. *See generally* Pursley, *supra* note 131, at 15–19 (presenting an in depth study of dormancy).

arguing that the Constitution just *means* that the state and federal governments have plenary and overlapping power.

Our basic federalism norm is not solely concerned with precluding interference with the structure; it also requires that government function effectively. The difficult task that Schapiro emphasizes is to balance an action's costs in structural interference against its benefits for federalism values and broader good government goals. Dualism is one way to adjudicate that balance. As Schapiro argues, the constitutional structure does not entail separate state and federal spheres, at least not without supplementation by a difficult, contestable interpretive case which, he notes, the Rehnquist Court did not make in *Lopez*.[139] Since Schapiro does not provide interpretive reasons for selecting one structural inference over another, perhaps we should consider dualism—and the polyphonic alternative—not as competing accounts of constitutional meaning but, rather, as competing sets of possible *decision rules* for implementing the underlying constitutional norm guaranteeing a federalist government that is effective and durable.

This third possible formulation of Schapiro's normative claim is, I believe, both the best reading of Schapiro's argument and the most promising normative strategy for compatibilism. Call this the "Rules Thesis":

> *RT*: Polyphonic federalism requires consideration of how complex intergovernmental interactions common in practice generate plurality, dialogue, and redundancy in governance, and the capacity of plurality, dialogue, and redundancy to advance broader goals of good government, when implementing basic constitutional federalism requirements.

Characterizing the normative claim as a claim about constitutional decision rules is consistent with the Supreme Court's rationale for adopting the commercial/noncommercial distinction in *Lopez*, which centered on instrumental concerns about the test's administrability.[140] It is also consistent with the reasons Schapiro gives for preferring polyphony to dualism in enforcing structural norms: polyphony provides "greater theoretical clarity and fewer doctrinal burdens."[141] That is the language of instrumental reasons for crafting doctrinal rules, not the language of constitutional interpretation. As Schapiro observes, "[t]he *content* of federalism cannot be determined on the basis of what would be easy for the courts to enforce."[142] The content of federalism decision rules, however, in part may be so determined. Additionally, as I will explain, there may be an even stronger instrumental reason to prefer RT over dualism: RT may reduce adjudicatory errors.

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139. SCHAPIRO, *supra* note 1, at 109.

140. *Id.* at 62, 110; *see Lopez*, 514 U.S. at 566 ("Admittedly, a determination whether an intrastate activity is commercial or noncommercial may in some cases result in legal uncertainty.").

141. SCHAPIRO, *supra* note 1, at 110.

142. *Id.* at 63 (emphasis added).

Considered as a cluster of instrumental arguments about federalism decision rules, Schapiro's case against dualism is strong. Distinguishing the "truly national" from the "truly local" may once have been a useful proxy for the difficult underlying inquiry into whether government action threatens the constitutional structure. It is notoriously difficult to balance the practical benefits of an action against its tendency to undermine the overall system. We need heuristics to enforce abstract constitutional norms—not just for courts, but for everyone who considers or must conform to them. In the nineteenth and early twentieth centuries, when federal action was still the interstitial exception to a general rule of state authority, it was, perhaps, fair to presume that federal intrusions into local matters were inconsistent with the constitutional structure, and vice versa.[143] But dualism's utility as a set of assumptions on which to base such heuristics has shrunk. Schapiro convincingly demonstrates that interactive federal–state regulatory regimes are becoming the norm rather than the exception, that they generally do not threaten the stability of the system, and that they may successfully promote the basic goals that justify the Constitution's structural commitments. Shifting to the language of instrumental concerns about constitutional adjudication, judicial efforts to separate the national and state spheres seem likely today to invalidate substantially more constitutionally permissible, and positively desirable, actions than impermissible ones. In other words, as a foundation for decision rules, dualism today creates a high probability of judicial error.

Reducing adjudicatory errors is a paradigmatic reason to modify constitutional decision rules. Schapiro insists that a better approach for implementing basic federalism requirements would have courts analyze the costs and benefits of the action along the dimensions of traditional and polyphonic federalism values. "Doctrinal structures can accommodate plurality, dialogue, and redundancy, while also fostering uniformity, finality, and hierarchal accountability. The overlap of state and federal authority can be managed so as to recognize both sets of values."[144] Schapiro's proposal, moreover, does not seem limited to changing the framework for adjudicating federalism disputes in courts. Where other decision makers are tasked with federalism issues, as, for example, when courts defer questions to Congress or agencies, the nonjudicial actors also need heuristics and should adopt those that will result in the fewest decisional errors. Polyphonic federalism, then, may best be viewed as a proposal for new federalism decision rules for everyone—courts, Congress, agencies, state officials, and the public alike.[145]

143. *See* Young, *supra* note 3, at 151–52 (noting that dualist federalism doctrines were more manageable before national economic and social integration).

144. *Id.* at 110.

145. This is one thing that distinguishes Schapiro's view from the view that courts should simply defer federalism questions to the political process. Schapiro appears to propose that actors in the political branches, too, need new federalism rules.

Reading the compatibilist normative claim as concerned with decision rules and the instrumental reasons for revising them avoids several theoretical difficulties that plague the other formulations that I have considered. Moreover, on this view, the Constitution need not be read as internally inconsistent: plenary federal and state power are not matters of constitutional mandate; they are doctrinal presumptions that help courts avoid errors in the form of too rigorously enforcing preclusions of government authority in the name of protecting the basic framework. Finally, while a thorough assessment of the merits of compatibilist proposals is a large task best left for future work, focusing our decision making on the proper set of federalism values does seem likely to reduce the rate of error somewhat. I think the Rules Thesis casts compatibilist views in their most persuasive light and advances a theoretical debate that can, at times, be dense, abstract, and perplexing.

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A compatibilist federalism claim formulated like the Rules Thesis responds to conventionalist arguments by giving legitimate reasons for underenforcing—not ignoring or abandoning—basic requirements of the constitutional structure. For example, compatibilists likely would reject the conventionalist claim that every instance of purportedly preemptive federal agency action must be clearly authorized by Congress.[146] Such a rigid rule does not invite a nuanced assessment of whether particular instances of preemption in fact promote the goals of governance. Conventionalists cannot adequately respond by simply insisting that Congress's role is "nonoptional"[147]—the nature of that claim is not entirely clear. Nonoptional constitutional requirements are set out in the interpretive part of constitutional doctrine—e.g., in our skeletal federalism norm.[148] And the Constitution actually mandates very little in the way of specific government structure, at least as a matter of meaning that is accepted across interpretive disciplines. Conventional arrangements for maintaining and fulfilling the broad goals of the structural features that are, in fact, "non-optional," such as the division of government into effective and durable national and state levels, may *seem* mandatory if they have a long history of success and are deeply engrained in judicial discourse and public consciousness. But most of the law of constitutional structure consists in decision rules, and those may be revised for instrumental reasons.

The claim that congressional authorization for agency preemption is mandatory depends on a strong, but not uncontestable, interpretation of the phrase "Laws of the United States" in the Constitution's Supremacy

146. *See* Benjamin & Young, *supra* note 12, at 2117 (arguing that agencies' preemptive actions must be clearly authorized by Congress, both because preemption raises federalism concerns and insofar as "an agency's role is whatever Congress gives it, and no more").

147. *Id.*

148. *See supra* notes 134–38 and accompanying text.

Clause.[149] Even if there is bona fide disagreement about the meaning of that Clause, courts nevertheless might adopt a doctrinal rule that generates substantially the same results as would adopting a Congress-centric interpretation of the Clause's language. The "requirement" of direct congressional authorization of all preemptive federal action, then, actually might be best characterized as a decision rule adopted in response to the famous rationale for the general "political safeguards" approach to federalism: the belief that Congress, rather than the Judiciary, is best suited to account for state interests in policy making and, thus, most likely to decide federalism questions correctly.[150] If circumstances change such that a different institution becomes better equipped than Congress to make federalism decisions, then it seems legitimate to adopt a decision rule allocating decision-making authority to that institution instead. Even granting *arguendo* the contestable interpretive claim that Congress's role in preemption *is* constitutionally mandatory, the same sort of instrumental considerations may nevertheless justify decision rules that *underenforce* that mandate and allow the better-situated institution to make preemption decisions in practice. Conventionalists may respond by conceding the scarcity of structural constitutional mandates and countering the instrumental case for abandoning conventional arrangements in favor of rules that permit innovative governance schemes. They may defend an interpretive case for more specific structural requirements and counter the instrumental case for judicial underenforcement sufficient to permit innovative governance schemes. Or, they may make conceptual arguments against the legitimacy of instrumentally determined decision rules in general. In short, defending traditional government and doctrinal arrangements against compatibilist calls for revision will require more conceptual nuance.[151]

Conclusion

I am not convinced that there is no more need for somewhat formal proxies in adjudicating federalism disputes. Highlighting the proper values does seem likely to prevent some judicial errors that would otherwise result under dualism, but multi-factored standards carry an inherent slipperiness that courts seem particularly ill-suited to manage. In the longer run, the costs

149. U.S. CONST., art. VI, cl. 2; *see* Benjamin & Young, *supra* note 12, at 2145–47; Bradford R. Clark, *Separation of Powers as a Safeguard of Federalism*, 79 TEXAS L. REV. 1321, 1330–31 (2001) (both arguing that preemptive "Laws" under the Supremacy Clause are only those passed through Article I's bicameralism and presentment process).

150. SCHAPIRO, *supra* note 1, at 86–87; *see* Herbert Wechsler, *The Political Safeguards of Federalism: The Role of the States in the Composition and Selection of the National Government*, 54 COLUM. L. REV. 543, 559 (1954) (positing that federal intervention as against the states is primarily a matter for congressional determination).

151. This is not to suggest that what I have been calling conventionalist scholarship lacks nuance generally; the truth is quite the contrary. I suggest only that additional analytic work must be done along the particular lines highlighted by the compatibilist challenge.

of rigorously applying such a standard might prove prohibitive, and the errors that would result from failing to devote sufficient resources to its rigorous application might outstep those that compatibilists are concerned about in connection with the dualist approach. A similar worry may motivate Schapiro's call for increased judicial deference to legislative and administrative bodies on federalism questions. In addition, Schapiro's case for relaxing doctrines that implement constitutional preclusions of *state* action seems somewhat less complete. The desirability of the current incarnations of these doctrines is an open and hotly contested question, and building an instrumental case one way or the other is a daunting project.

Still, I think that compatibilist federalism arguments are correct to emphasize that the complex realities of the world in which government must operate today call for our decision making about the structure of government to become substantially more nuanced than the dualist conception permits. What I have tried to make clear here is that debates about the permissibility of structural innovations often cannot—and, thankfully, need not—be resolved by resorting to arguments about constitutional interpretation. What needs modification are our decision rules, and deciding on the proper modifications involves practical reasoning, not abstract interpretive theorizing. Read as an instrumental case for modifying the doctrinal rules courts employ to implement federalism norms—as well as the decision-making heuristics of policy makers, commentators, and the public at large—*Polyphonic Federalism* is a formidable contribution.

Book Review Symposium

The Common Man?

JUSTICE BRENNAN: LIBERAL CHAMPION. By Seth Stern & Stephen Wermiel. Houghton Mifflin Harcourt. 2010. Pp. 688, $35.00.

Marsha S. Berzon*

Judges, and Justices, are just not all that *interesting*, usually. I deal with judges daily. And, although those I work with are, to a person, incredibly hard working, smart, and well intentioned, they tend to be, as Justice Brennan was, as I quite definitely am, people with a fairly narrow set of interests, admirable but pedestrian lives, and, operating as they do in relative isolation, a perspective on their times no more reliable or wide-ranging than that of the run of the citizenry.

An exception to this perhaps hard generalization was, according to Gerald Gunther's biography,[1] Learned Hand, because Judge Hand *was* interesting, a public intellectual who happened to be a judge. In contrast, one cannot imagine Justice Brennan having had the enormous impact on our society that he did *except* as a judge. The title of a book of remembrances published by the Brennan Center for Justice at NYU Law School,[2] an organization established in his honor after his death largely by former clerks, is "The Common Man as Uncommon Man,"[3] purloining a phrase used by David Halberstam to describe Justice Brennan. An apt description, and one that bespeaks both affection for the person and respect for his enormous accomplishments.

Yet, what provided Justice Brennan the chance to be "uncommon" was, I suspect, not any foreordained destiny. Instead, it was that, for fairly fortuitous reasons,[4] he was appointed to the Supreme Court of the United States in 1956. As a reader of the biography comes to appreciate as she wades through the more than 500 pages of information and analysis, both halves of

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1. *See generally* GERALD GUNTHER, LEARNED HAND: THE MAN AND THE JUDGE (1994).

2. THE COMMON MAN AS UNCOMMON MAN: REMEMBERING JUSTICE WILLIAM J. BRENNAN, JR. (E. Joshua Rosenkranz & Thomas M. Jorde eds., 2006).

3. David Halberstam, *The Common Man as Uncommon Man*, *in* REASON & PASSION: JUSTICE BRENNAN'S ENDURING INFLUENCE 22, 22 (E. Joshua Rosenkranz & Bernard Schwartz eds., 1997).

4. *See* SETH STERN & STEPHEN WERMIEL, JUSTICE BRENNAN: LIBERAL CHAMPION 71–95 (2010) (describing President Eisenhower's search for a young Catholic with court experience to fill the vacancy).

that fortuity mattered mightily—that it was the Supreme Court, and that it was 1956.

The biography can be usefully mined with respect to the first point. As becomes clear as one reads on, the attributes needed by a judge on a collective court, particularly one as large and prominent as the United States Supreme Court, go well beyond intellectual prowess and an engaging writing style. The contrast between the native brilliance of Justices Felix Frankfurter and William Douglas on the one hand and the more practical attributes of Justice Brennan on the other nicely captures the point. The contrast in their comparative effectiveness is drawn out in the book, with Justices Frankfurter and Douglas very much the losers. One does not have to buy the backslapping Irishman version of the good Justice—which neither I nor the book's authors do—to recognize that Justice Brennan's willingness to sacrifice doctrinal purity and perfectly organized opinions in the effort to put together majority decisions was a trait essential to his ultimate impact on the Court. For, academic critiques notwithstanding, that flexibility—including the willingness to write opinions more narrowly than he might have wished—was often essential to getting done what needed getting done: avoiding the fractured decisions that confound litigants and lower courts and require doing a second time—when the court personnel changes or the case is better presented—what could otherwise be done once, if less than perfectly.[5]

To turn to the timing point at somewhat greater length: Just two years before Justice Brennan's nomination, the Court had decided *Brown v. Board of Education*.[6] In all the current political and academic banter about the proper role of judges,[7] *Brown* has remained inviolate—the iconic example of what our courts are there to do, of a necessary constitutional intervention when the other branches of government could not act, of a decision which every judge and justice now sitting on the bench professes to be sure he or she would have joined, and been proud to join, had he or she been in the position to do so. But in 1956, of course, both the legitimacy and impact of

5. On the writing front, I should note, Justice Brennan was no slouch. I often tell my clerks that although Justice Brennan usually accepted the basic organization and analysis of my first drafts, he always added at least a few sentences—and those sentences were the ones that appeared in newspapers, summarizing the holding and bringing home to the lay public the rationale and import of that holding.

6. Brown v. Bd. of Educ., 347 U.S. 483 (1954).

7. *See, e.g.*, Confirmation Hearing on the Nomination of John G. Roberts, Jr. to Be Chief Justice of the United States: Hearing before the S. Comm. on the Judiciary, 109th Cong. 55 (2005) (statement of John G. Roberts, Jr.) ("[A]nd I will remember that it's my job to call balls and strikes, and not to pitch or bat."); Richard A. Posner, *The Role of the Judge in the Twenty-First Century*, 86 B.U. L. REV. 1049, 1051 (2006) (discussing the "principle conceptions of the judicial role"); Major Garrett, *Obama Pushes for 'Empathetic' Supreme Court Justices*, FOXNEWS.COM (May 1, 2009), http://www.foxnews.com/politics/2009/05/01/obama-pushes-empathetic-supreme-court-justices/ (quoting President Obama as seeking a Justice who "understand[] and identify[] with people's hopes and struggles").

Brown was up for grabs, and the role of the Court in transforming principle into reality was yet to be defined.[8]

As it turned out, the Court's grappling with desegregation and the civil rights movement had doctrinal ramifications that went far beyond the vastly influential equal protection/racial discrimination principles developed in the wake of *Brown*.[9] For one thing, the seminal constitutional defamation case, *New York Times v. Sullivan*,[10] was a direct outgrowth of the situation in the South: As the biography reports, there were forces in the South who saw large libel judgments for small factual errors as a way of driving out the national media from the region and thereby lessening the pressure to desegregate.[11] Mistrust of Southern judges and juries also underlay *Fay v. Noia*,[12] Justice Brennan's landmark—but since overruled—habeas corpus case. Although itself a case from New York, *Fay* undoubtedly reflected concerns about whether state courts in the South could be trusted fairly to decide criminal cases concerning African-American defendants and, more specifically, civil rights activists.[13]

There was another, perhaps less obvious spinoff of the race discrimination cases: The development, starting in 1971, of the line of constitutional sex discrimination cases that culminated in *Craig v. Boren*,[14] Justice Brennan's opinion that finally settled on an intermediate standard of constitutional review for sex discrimination cases. As several recent

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8. *See, e.g.*, Reva B. Siegel, *Equality Talk: Antisubordination and Anticlassification Values in Constitutional Struggles Over* Brown, 117 HARV. L. REV. 1470, 1478–99 (2004).

9. *See, e.g.*, Alexander v. Holmes County Bd. of Educ., 396 U.S. 19, 20 (1969) (holding that all school districts are obligated to end school segregation); Green v. Cnty. Sch. Bd. of New Kent Cnty., 391 U.S. 430 (1968) (holding that a school board's freedom-of-choice plan was not a sufficiently speedy step toward desegregation and thus violated *Brown v. Bd. of Educ.* (*Brown II*), 349 U.S. 294, 300–01 (1955)); Loving v. Virginia, 388 U.S. 1, 12 (1967) (striking down race-based legal restrictions on marriage); Cooper v. Aaron, 358 U.S. 1, 17–20 (1958) (declaring state governors and legislatures bound by *Brown* to avoid postponing the desegregation of schools).

10. New York Times Co. v. Sullivan, 376 U.S. 254 (1964).

11. *See* Stern & Wermiel, *supra* note 4, at 220–21 ("Such enormous awards threatened to drive out of the South reporters from major media organizations—exactly the intended goal of those filing the suits.").

12. 372 U.S. 391 (1963), *overruled in part by* Wainwright v. Sykes, 433 U.S. 72 (1977) *and abrogated by* Coleman v. Thompson, 501 U.S. 722 (1991).

13. *See generally* Larry Yackle, *The Story of* Fay v. Noia*: Another Case About Another Federalism*, *in* FEDERAL COURTS STORIES 191 (Vicki C. Jackson & Judith Resnik eds., 2010) (discussing the origin of *Fay*'s holding that a state prisoner would be barred from raising a federal claim in federal habeas only if he had deliberately bypassed a previous opportunity to advance the claim in state court); *see also* Henry v. Mississippi, 379 U.S. 443, 450 (1965) (relying in part on *Fay v. Noia* to vacate the conviction of famed civil rights activist Aaron Henry by a Mississippi court and remand for a hearing); Beckwith v. Anderson, 89 F. Supp. 2d 788, 792 (2000) (recounting Byron de la Beckwith's 1994 conviction and life imprisonment sentence in 1994); John Herbers, *Beckwith's 2d Trial Ends in Hung Jury*, N.Y. TIMES, Apr. 18, 1964, at A1 (describing the second all-white jury which failed to convict Beckwith for the murder of NAACP official Medgar Evers).

14. 429 U.S. 190 (1976).

commentators have noted,[15] both the impetus for the litigation that generated and shaped the cases that came before the Court and the Court's willingness, for the first time, to view discrimination based on sex as worthy of the Court's concern in many ways mimicked the earlier developments regarding race-based discrimination. And Justice Brennan was in the lead with regard to the gender cases as he had been, and continued to be, in the race cases, writing a plurality opinion for the Court in *Frontiero v. Richardson*[16] in 1972 that would have equated sex with race discrimination for constitutional purposes by applying strict scrutiny to governmental sex discrimination.

The sex discrimination cases have received particular focus in the reviews of Stern and Wermeil's biography,[17] because both before and, astonishingly, after *Frontiero*, Justice Brennan was personally uncomfortable with women lawyers and law clerks, and with the prospect of a women Justice on the Supreme Court.[18] In 1966, he told one law school dean who was proposing clerks for him that while "for equal rights for women, . . . my prejudices are still for the male";[19] in 1970, he turned down a recommendation from two former clerks teaching at Boalt Hall Law School at Berkeley of an exemplary woman candidate; in 1973, Justice Brennan initially refused to hire me as his first woman clerk when Professor Stephen Barnett once again chose a woman for the slot Justice Brennan allocated to Boalt every few years; and, reportedly, Justice Brennan was so uncomfortable with the notion of serving with a woman Justice that he thought he'd resign were one ever appointed.[20]

It is odd, for me, to have been part of this story as well as a reader about it. I never knew until reading *Justice Brennan* the entire tale behind the phone call I got from Justice Brennan in the spring of 1973 offering me the clerkship, but I did know that something odd had happened: I was asked by Professor Barnett in the fall of 1972 whether I was interested in the clerkship, then told a few months later that I'd not been chosen (although I was never told who was). Then, still more months later, Judge James R. Browning, the Ninth Circuit judge for whom I was clerking, came into my office to tell me

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15. *See, e.g.*, GAIL COLLINS, WHEN EVERYTHING CHANGED: THE AMAZING JOURNEY OF AMERICAN WOMEN FROM 1960 TO THE PRESENT 89–93 (2009); Serena Mayeri, *Reconstructing the Race-Sex Analogy*, 49 WM. & MARY L. REV. 1789, 1796–97 (2008).

16. 411 U.S. 677 (1973).

17. *See* Justin Driver, *Robust and Wide-Open*, NEW REPUBLIC, Feb. 17, 2011, at 36, 38; David J. Garrow, *The Original Activist Judge*, WASH. POST, Oct. 17, 2010, at B1, *available at* http://www.washingtonpost.com/wp-dyn/content/article/2010/10/15/AR2010101502672.html; Nina Totenberg, *Justice Brennan: A Liberal Icon Gets Another Look,* NPR (Nov. 26, 2010), http://www.npr.org/2010/11/24/131567727/justice-brennan-a-liberal-icon-gets-another-look; Ed Whelan, *Justice Brennan on Female Law Clerks and Justices*, NATIONAL REVIEW ONLINE—BENCH MEMOS (July 22, 2010), http://www.nationalreview.com/bench-memos/231303/justice-brennan-female-law-clerks-and-justices/ed-whelan.

18. *See* STERN & WERMIEL, *supra* note 4, at 385–408.

19. *Id.* at 386–87.

20. *Id.* at 388–89, 399.

that he thought I'd be hearing from Justice Brennan—and I did, in a call in which Justice Brennan, with his usual graciousness, invited me to serve as his law clerk the following term. The only hint of a back story was that Professor Barnett warned me over dinner before I left to be particularly nice to Mary Fowler, Justice Brennan's indispensable secretary and later wife.

I learned part of the larger back story after Justice Brennan died, when I finally had the nerve directly to ask Professor Barnett what had happened, and was told, as recounted in detail in the biography,[21] that the Justice had turned me down on the basis of gender, but that Professor Barnett—quite the hero of this story[22]—had challenged his decision and changed his mind. As it turns out, Professor Barnett did exactly what I would hope any former clerk of mine would do if he or she knew that I was putting my legacy and reputation in danger: He wrote an amazingly forthright letter to the Justice, suggesting that the gender-based hiring decisions were "both unconstitutional and simply wrong," warning that at some point there could be a lawsuit about the issue (not that I was about to bring one), and concluding with both an appeal to higher values—noting that the Justice would not want a daughter or granddaughter denied opportunities because of gender—and to legalities—noting that if subpoenaed, he, Barnett, would tell the truth.[23]

After adding that neither I nor my co-clerks ever perceived any difference in treatment between me and the "boys" once I arrived in chambers,[24] the authors of the biography make of all this that Brennan "strictly compartmentalized his Court opinions and his life, often taking positions in opinions that were far more liberal than his own personal views."[25] To the degree this assessment can be read as perjorative—and, certainly, some of the commentators on the biography have read into this episode, combined with the earlier rejection of a women clerk and the failure to hire another woman clerk for seven years,[26] hypocrisy or worse[27]—I would demur.

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21. *Id.* at 399–400.

22. Professor Stephen Barnett passed away on October 13, 2009.

23. STERN & WERMIEL, *supra* note 4, at 400.

24. *Id.* at 401. The biography also reports, as I have described in writing about the Justice, that Justice Brennan and I both had child care responsibilities that term, he with regard to his granddaughter and me for my two-year-old son. *Id.* at 401–02; *see also* Marsha S. Berzon, *Justice Brennan's Childcare Issues, in* THE COMMON MAN AS UNCOMMON MAN: REMEMBERING JUSTICE WILLIAM J. BRENNAN, JR., *supra* note 2, at 77, 77–79; Marsha S. Berzon, *Honorable William J. Brennan, Jr.: Remarks of Marsha S. Berzon*, 118B S. Ct. at 63; Marsha S. Berzon, Dedication, 31 LOY. L.A. L. REV. 739, 740–41 (1998).

25. STERN & WERMIEL, *supra* note 4, at 399.

26. *Id.* at 406.

27. *See* Whelan, *supra* note 17 (describing Justice Brennan's behavior in this area as "surprising").

As I have noted elsewhere[28] and as Justice Ruth Ginsburg put it succinctly in a comment to the biographers, Justice Brennan "'was a man brought up in a certain age,'" in which women rarely had professional jobs and men were used to speaking one way to other men and, as a matter of respect, in a more genteel manner to women.[29] To me, one measure of the "uncommon man" that Justice Brennan was is that, despite his personal comfort zone, he was able to appreciate and expound on the *principle* that sex-based discrimination bears a close resemblance to, and has no more place in the modern world than does, the race-based discrimination with which he had wrestled for many years on the Court. And a second measure is that he was able, once an objective outsider pointed out the tension between the principles he asserted publicly and his personnel decision, to admit he was wrong and reverse his decision.

Seeing beyond the assumptions of the world in which one grew up can take time, intellectual effort, and gentle prodding from others—like the Justice's daughter Nancy—who have different visions and different experiences. (Indeed, with regard particularly to the reaction of members of the Supreme Court to women's rights issues, I do not discount the daughter quotient—daughters with their own professional aspirations and childcare issues—as a major influence on the outcome of more than one case.) That Justice Brennan was able to understand the sex discrimination rights claim *en gros*, well before appreciating the need to implement it in his daily life, indicates to me not a weakness in his legal rulings but the strength that the principle of equal treatment and dignity, despite outward differences, had acquired in his constitutional lexicon of values by the early nineteen seventies, after he had served on the Court for a decade and a half. Drafters of statutes—and constitutions—may be able to state with confidence and commitment a broad principle while not being able to foresee the application of the principle to real world circumstances. That is why I tend to be skeptical of the variety of statutory interpretation or constitutional originalism which looks at the contemporaneous behavior or projections of the progenitors of the statute or constitutional provision as indicative of the meaning of their broad pronouncement, even though the pronouncement is intended for application by others and in the future, not by themselves and now. Similarly, Justice Brennan's delay in conforming his behavior to his pronouncements with regard to sex-based discrimination does not undermine his jurisprudence. It merely demonstrates, as does much else about him, that he was at once common *and* uncommon, a product of his times but a person

28. *See* Berzon, Dedication, *supra* note 24, at 741 (noting that lawyers arguing sex discrimination cases to the Court at this time had to help the Justices see beyond the gender roles to which they had become accustomed).

29. STERN & WERMIEL, *supra* note 4, at 405 (quoting Interview with Ruth Bader Ginsburg, Associate Justice, United States Supreme Court (Feb. 13, 2008).

with both the aspiration and, as it proved out, the ability to influence future times by reminding us all of our better selves.

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Believing in the Goodness of People

JUSTICE BRENNAN: LIBERAL CHAMPION. By Seth Stern & Stephen Wermiel. Houghton Mifflin Harcourt. 2010. Pp. 688, $35.00.

Larry Kramer*

Judicial biography is a punishing genre. Anyone brave or foolish enough to venture on to this territory starts with a big disadvantage, namely, that it's exceedingly difficult to make what judges do seem exciting.[1] That judicial biographies make unlikely page-turners is hardly a surprise. The substance of a judicial life—at least of judges whose work on the bench merits serious biography—is inevitably dominated by the cases the judge decided. Yet even the hardiest, most avid consumer of law will begin to nod sleepily if asked to spend hours on end reading about lawsuits.

Unfortunately, Seth Stern and Stephen Wermiel were unable to surmount the inherent limitations of the genre in their biography of Justice William J. Brennan. I don't mean this as harshly as it may sound. After all, Stern and Wermiel had to work with some serious constraints, including that Justice Brennan's life before he went on the bench wasn't particularly interesting, that the Justice involved himself in almost nothing off-the-bench, and—most problematic for the authors—that Brennan was extremely withholding and reserved in and about his personal life. Stern and Wermiel note this last quality at numerous points in the book,[2] but it bears underscoring. Bill Brennan was a delightfully friendly and gregarious person. No one who met him disliked him, no matter how much they might have disagreed with his views. He was effusively warm, and people came away from conversations feeling as if they had a new, caring friend. It was only later that one realized the extent to which the Justice's effusiveness was itself a form of reserve, a wall behind which he hid, and that he had revealed little about himself or his own feelings.

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1. TV networks have learned this lesson the hard way. ABC and CBS launched dramas about the Supreme Court that quickly failed for, well, lack of drama; NBC sought to sidestep the trap by having its main character resign from the Supreme Court, but its show is failing too. Nor is the problem with these shows lack of star power. Sally Fields starred in ABC's "The Court," while Joe Mantegna headed the cast of CBS's "First Monday." Jimmy Smits stars in NBC's "Outlaw," which is still on the air but not likely to last much longer.

2. SETH STERN & STEPHEN WERMIEL, JUSTICE BRENNAN: LIBERAL CHAMPION 30, 105, 402–03 (2010).

Stern and Wermiel's biography suffers as well from the fact that it took twenty-five years to complete. A quarter century is too long to gather and sit on material, particularly if the material is voluminous on the public side and thin on the private one. From the authors' perspective, the resulting biography may seem like an extreme distillation. To a reader, however, 547 pages—452 of which consist chiefly of descriptions of how cases were decided—is too much, even when written with the clean, light touch Stern and Wermiel brought to the project.

Stern and Wermiel do not write only about cases, of course, and one does learn interesting facts along the way. Some of these—such as the Justice's discomfort with women clerks,[3] his scandalous treatment of Mike Tigar,[4] and his personal opposition to abortion[5]—have been written about elsewhere but will be new to readers learning about Justice Brennan for the first time. Other facts are interesting in light of what has happened since Justice Brennan died. Given the makeup of today's Supreme Court, for example, it is remarkable to read that when Justice Brennan was appointed, he was the Court's *only* member with prior judicial experience.[6] Equally striking is the realization that Brennan played the crucial role he did during the Warren Court's heyday, not because he had Svengali-like powers to manipulate others, and not because he possessed a Madisonian genius at coalition-building, but because he was the Court's swing vote: less liberal than Douglas, Black, Warren, or Goldberg/Fortas/Marshall; less conservative than Clark, Frankfurter, Harlan, Stewart, or White.[7] It speaks volumes about the Supreme Court's political drift since the departure of Earl Warren to note that the Court's center has shifted from Brennan to Powell to O'Connor to Kennedy. Seen in that light, the notion that the current Court has a "liberal" wing seems downright silly. There is, to be sure, a wing of the Court that is less conservative than the Court's other wing. But to call that wing "liberal" in the Warren Court tradition is ludicrous. (In saying this, I take no position on whether it is good or bad to have a liberal wing. I want only to note that the one we have now is, if anything, more conservative than the conservative wing of the Warren Court.)

But facts and description are not enough to carry this biography, if only because we already know so much about the Supreme Courts on which Justice Brennan sat. What was needed, and what is missing from this biography, is an effort to grapple with the real puzzle of Justice Brennan's legacy, to wit: How did this ordinary man become such an extraordinary judge?

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3. *Id.* at 399–401.
4. *Id.* at 264–74.
5. *Id.* at 399.
6. *Id.* at 98–99.
7. *See, e.g.*, *id.* at 254 (describing Justice Brennan's moderate position on obscenity law).

To call William Brennan an ordinary man is no insult. I mean only that there was nothing remarkable about his upbringing or achievements before ascending to the Supreme Court. He was a capable law student, but no more; a good lawyer, but no more; a competent state court judge, but no more. He did not have an especially powerful intellect and was not a dazzling legal analyst. Certainly many of his colleagues on the bench were more impressive intellectually. One cannot say that, as a lawyer or an intellectual, Justice Brennan surpassed the likes of Black, Douglas, Frankfurter, Harlan, Rehnquist, Scalia, Stevens, or White.

Yet he did surpass them as a judge. The extent of Brennan's impact was brought home to me during a debate I participated in not long after the Justice died. Sponsored by the New York City lawyers' chapter of the Federalist Society, the debate was entitled "Justice Brennan: Hero or Villain?" There were no other choices it seems—just hero or villain—and the point was to evaluate Justice Brennan's legacy. The attitude of the audience toward Brennan was remarkable. For as much as they reviled the Justice (and they did), they also respected him. Under his guidance, they said, the Supreme Court remade American society. The changes may have been bad ones, they thought, but audience members were almost in awe at how the Justice had managed to do it. They seemed really to believe, at least so they said, that we live in a society practically ruled by judges and that Justice Brennan deserves most of the credit (or blame).

Claims like this are obviously exaggerated. Courts have never managed to produce more than marginal changes in society unless and until they were aided or guided by the legislative and executive branches. But to say that the Supreme Court has never been a principal mover in effecting significant social change is not to say that it has been unimportant. The members of this audience were convinced that Justice Brennan led whatever changes the Supreme Court had managed to make. They saw him as an enormously effective judge, and that is a verdict with which I wholeheartedly concur.

How, then, did he do it? How did this unexceptional lawyer become one of the twentieth century's most exceptional judges? Justice Brennan's influence is usually ascribed to his ability to assemble coalitions, a theme that also pervades Stern and Wermiel's account.[8] And Brennan was indeed a coalition builder—though "building a coalition" mostly meant putting into opinions anything to get that fifth vote, no matter how inconsistent or at odds with the rest of the analysis, leaving the Court to sort out whatever mess was created in later cases. The Justice was, in this sense, a successful

8. *Id.* at 223–24 (describing Chief Justice Warren's choice of Justice Brennan to author the opinion in *New York Times Co. v. Sullivan*, 376 U.S. 254 (1964), as influenced by the fact that "Warren . . . knew that Brennan could build and hold on to a majority—a unanimous one if possible—in a way that he or other justices could not"); *id.* at 545 ("Brennan was extraordinarily successful in building coalitions—even if that sometimes meant sacrificing clarity in the process—by accommodating his fellow justices' concerns.").

accommodationist with the patience to let his positions unfold slowly, and his ability to mold the Court's doctrine over time using this strategy was indeed remarkable. But that still doesn't really answer the question, because something had to make Brennan's fellow Justices willing to be part of his coalitions in the first place. Something had to make them amenable to following Brennan's lead by joining opinions at the low cost of an added footnote or sentence or two of text.

No one can say for sure what made Brennan's leadership attractive to his strong-willed, independent colleagues, but I believe he succeeded because of who he was as a person. I am thinking of one quality in particular. Justice Brennan was, so far as I observed, someone who did not hate: someone without anger, without malice, without bitterness. He is the only person I have ever met about whom I would say this. The rest of us have things that make us spiteful and small. And whether we like it or not, whether we admit it or not, those things play a part in molding our judgments, often without our conscious awareness. This simply was not true of Justice Brennan. Spite simply was not in him or part of him. Yes, he sometimes acted as if he were angry, as if he disliked someone or hated something. But his heart was never really in it. The good will that everyone who met him experienced was always there, peeking through. It was as if, in expressing anger, Justice Brennan was going through the motions, trying to act like the rest of us. But a grin and self-conscious laugh were invariably just beneath the surface.

This is a slightly different point from one that is often made about Justice Brennan: that he was a charming man. He was most definitely charming. But his charm came partly from the quality I am describing, which was inborn. Justice Brennan had a genuine, almost automatic, empathy for everyone and everything. This was my impression, at least, from the peculiar, and peculiarly close, vantage afforded a law clerk. (I should add, as well, that I worked for Justice Brennan during the dark days, or what we thought of as the dark days: when the Justice had long ceased winning very often, when we were producing two to three times as many dissents as opinions for the Court, when we talked about "defensive denials" of certiorari and could call the clerk's office to tell them to run the "usual" dissent in capital cases because we were running it so often.)

What made Justice Brennan an extraordinary judge, in my view, was how this unique personal quality guided and became part of his judging. Justice Brennan believed in the goodness of people. He believed in the dignity of each individual and in the capacity of each person to be better. He believed these things not in some abstract philosophical or intellectual sense, but naturally and instinctively. He confronted evil, of course, and he saw people do terrible things. His opposition to racism and the death penalty was heartfelt. But the way he responded to these wrongs was motivated less by anger at the perpetrators than by a belief that they could learn, could change, could be better. The Justice understood that people make mistakes and

commit evil acts. He understood that people are often less than their best selves. He understood that institutions made up of people acting in complete good faith could still do bad things. But his decisions and his judgments reflected a deep and abiding faith in the possibility of progress. He believed that the Constitution could incite and inspire us to be better and to do better.

A great many complex issues need to be sorted out before such ideas can be turned into a jurisprudence, and I don't know that Justice Brennan ever did so. There are questions to answer about the role of judges and precedent, about separation of powers and democracy, about translating concepts over time, and about fidelity to text and to history. But fundamentally, it was this absence of ill-will, this simple quality of believing in the goodness of people, that lay at the heart of Justice Brennan's judging and that I believe constituted the fundamental motivating force behind his choices. There was a sure courage in Justice Brennan's willingness to push boundaries, a sense of rightness and absence of doubt that grew from his faith in people. And it was this faith, I think, that made his efforts and leadership attractive, even to colleagues troubled by gaps or weaknesses in the intellectual underpinnings.

Justice Brennan's work may or may not stand. We may one day find that everything he did or tried to do has been rejected, his major decisions all repudiated or abandoned. Yet even then, I suspect, he will still be remembered as one of the great Justices of the Supreme Court, if only for the humanity of his opinions and his judicial career.

History has a curious way of remembering well those who—like Justice Brennan—act on the basis of faith that we could be better rather than fear that we could be worse. It is why, given a choice, most of us would rather be Jefferson than Adams, rather be Madison than Hamilton, rather be Lincoln than just about anyone else. It is why most of us would rather be Louis Brandeis or Earl Warren than Oliver Wendell Holmes or Felix Frankfurter. History does not forget the cynics, but it favors men and women like Justice Brennan and for good reason. As a person, and so as a judge and a public figure, William J. Brennan inspired those who had contact with him—whether personally or through his opinions—to strive to do and be better. It was his most special quality and the one I know I remember him for.

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Our Liberalism

JUSTICE BRENNAN: LIBERAL CHAMPION. By Seth Stern & Stephen Wermiel. Houghton Mifflin Harcourt. 2010. Pp. 688, $35.00.

Frank I. Michelman*

Near the start of their vibrant new biography, *Justice Brennan: Liberal Champion*,[1] Seth Stern and Stephen Wermiel provide us with a frame to put around their story. Take it, they suggest, as a tale of surprise: not that Brennan's service on the U.S. Supreme Court should have turned out liberal,[2] but that it should have turned out historically momentous. Not only—so say the authors—did Brennan become arguably ("perhaps") the "most influential justice of the entire twentieth century," he also did surely become (no reservation here) "the most forceful and effective liberal ever to serve on the Court."[3]

These are bold and intriguing claims. To give the first its due, let us, for now, take "influence" to refer to more or less immediately traceable effects on legal outcomes and doctrinal content by work performed in the official capacity of a justice of the Supreme Court of the United States. If we relax the "most influential justice of the entire twentieth century" claim much beyond that rather close restriction, and especially if we allow "influential" to suggest a wide, deep, and enduring impression left by a prominent thinker on intellectual life and civic culture at large, the cases for Holmes and Brandeis might seem hard to beat.

Something similar may hold for the second claim—that of Brennan as the champion *liberal* ever to grace the Court. (Brandeis the people's lawyer? Frankfurter the public intellectual and FDR confidante? Warren the Super

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1. SETH STERN & STEPHEN WERMIEL, JUSTICE BRENNAN: LIBERAL CHAMPION (2010). It is a very good book—certainly now, and doubtless destined to remain, the authoritative "life" of Brennan the man and the Justice, luminously, perceptively, and candidly presented. I would guess that most who knew or worked with Brennan, or who have looked hard at his judicial judgments and opinions, or who have thought hard about the life and times of the Warren Court and its proximate successors, will find that the accounts of Stern and Wermiel both chime convincingly with what they think they know already and tell them (most of us, anyway) much that is interesting that they didn't know before.

2. *See* Stephen J. Wermiel, *The Nomination of Justice Brennan: Eisenhower's Mistake? A Look at the Historical Record*, 11 CONST. COMMENT. 515, 536–37 (1995) (confirming reports of Eisenhower's dissatisfaction with Brennan's liberalism as a Justice and showing why the President should have seen it coming).

3. STERN & WERMIEL, *supra* note 1, at xiii.

Chief? Senator Black? Douglas of New Haven and the SEC? Marshall the great cause lawyer?) It must have been with a strict focus on career-as-justice-influencing-doctrine that our authors selected Brennan as beyond argument our history's premier liberal jurist. His liberal testament in his doctrine lies.

Having tabled their claim for Brennan's liberal-champion status, the authors do not have a great deal to say by way of elaboration. Much of what they do offer comes on the heels of their statement of the claim. Brennan, they continue on,

> interpreted the Constitution expansively to broaden rights as well as create new ones for minorities, women, the poor, and the press. His decisions helped open the doors of the country's courthouses to citizens seeking redress from their government and ensured that their votes would count equally on Election Day. Behind the scenes, he quietly helped craft a constitutional right to privacy, including access to abortion, and bolstered the rights of criminal defendants,

to which we may add some adjacent remarks linking Brennan to welfare-state redistributionist policies.[4] "In the process," add the authors, Brennan "came to embody an assertive vision for the courts in which judges aggressively tackled the nation's most complicated and divisive social problems."[5]

Concerning Brennan's liberalism, the mood of the book seems unreservedly celebratory; I pick up no ironic undertow, no minor mode of doubt or second thought to contest with the tonality of the major. *Justice Brennan*—no work of hagiography—is larded with capable, candid, critical reflection on quite a few of Brennan's choices and their consequences. But what is in doubt is never Brennan's liberal cause; it is only, sometimes, his consistency in the cause or his judgments in its service.[6] Liberalism as doctrine, liberalism à la Brennan, comes through unscathed.

But still what is that, exactly? The authors give us a profile in the form of data points: a sympathy for social underdogs and outcasts; a concern for social de-stratification, inclusion, and redress; a faith in rights—as correctives against routinizations of power, as guarantors of robust political contestation, and as shields for individual self-direction in deeply personal matters; and so a corresponding pull to judicial assertiveness. It is left to us, though, to connect the dots as liberalism.

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4. *See id.* at 317–18 (associating President Lyndon Johnson's "Great Society" with a "liberal consensus" spoken for by the Warren Court). Additional clues to what the authors mean by "liberal" can be mined from scattered other passages. *See, e.g.*, *id.* at 101–02, 128 (coloring Frankfurterian judicial restraint as "conservative" and a more activist judicial posture as "liberal").

5. *Id.* at xiii.

6. As in the matter of the aborted clerkship of Michael Tigar, see *id.* at 264–74, or the obscenity prosecution of Ralph Ginzburg, see *id.* at 249–64, 274–75.

Is there some established theoretical lexicon in which aptly to class as liberal the jurist thus portrayed? One that it will not be is that of our standard general histories of Western political ideas, for if we focus on the term's most steadfast significations in that discourse, we'll have trouble explaining how Brennan—stout defender of the uses of reverse race-based discrimination,[7] of the state's power to impair undoubtedly lawful property holdings for non-urgent reasons,[8] of "welfare" at taxpayer expense[9]—could possibly turn up as hands-down liberal champion. A "classical" liberal—a Milton Friedman[10] or a Friedrich Hayek[11]—he plainly is not, nor yet a pragmatist-liberal like Richard Posner.[12]

But hey, Earth to Frank, our authors are not writing as general historians or general theorists of political ideas. Why not just take them to be talking the talk of recent and contemporary American political polemics, as in "bleeding-heart," "pointy-headed," or "limousine" liberal—all referring to an aggregation of political stances supposedly most at home among so-called elites in blue states, college towns, and upscale suburbs (soft on crime, on cultural deviance, on licentious expression, on indigence; suspicious of the police, property rights, self-reliance, traditional values, and discipline in general)? Why not? Because, in the first place, it is not especially flattering to crown a man champ of *that* crowd. And because, in the second place, such a contemporary political-polemical reading of Stern and Wermiel's "liberal" would not self-evidently take in the book's emphasis on Brennan's judicial activism (the Rehnquist and Roberts Courts as liberal?[13]) or on

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7. *See* Metro Broad., Inc. v. Fed. Commc'ns Comm'n, 497 U.S. 547, 552 (1990) (holding that the FCC's policies of awarding preferences to minority owners in comparative licensing proceedings and permitting certain television and radio broadcast stations to be transferred only to minority-controlled firms did not violate equal protection principles); Regents of the Univ. of Cal. v. Bakke, 438 U.S. 265, 324–25 (1978) (holding that "Government may take race into account when it acts . . . to remedy disadvantages cast on minorities by past racial prejudice . . . .").

8. *See* Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 137–38 (1978) (holding that a city may place restrictions on the development of historical landmarks without necessarily effecting a "taking" requiring the payment of "just compensation").

9. *See* Goldberg v. Kelly, 397 U.S. 254, 270 (1970) (holding that welfare recipients must be granted "an opportunity to confront and cross-examine the witnesses relied on by the [State Department of Social Services]" in discontinuing or suspending the recipient's financial aid); Shapiro v. Thompson, 394 U.S. 618, 632–33 (1969) (holding that certain residency requirements precluding people from welfare benefits are unconstitutional).

10. *See* MILTON FRIEDMAN, CAPITALISM AND FREEDOM 5 (1962) (claiming title to "liberalism").

11. *See* F.A. HAYEK, NEW STUDIES IN PHILOSOPHY, POLITICS, ECONOMICS AND THE HISTORY OF IDEAS 119–51 (1978) (discussing history and meanings of "liberalism").

12. *See* RICHARD A. POSNER, OVERCOMING LAW 1–19 (1995) (linking liberalism to pragmatism and embracing both).

13. *See* Citizens United v. Fed. Election Comm'n, 130 S.Ct. 876, 917 (2010) (holding that corporate independent expenditures on political broadcasts in candidate elections cannot be limited); Bush v. Gore, 531 U.S. 98, 110 (2000) (reversing the Florida Supreme Court's judgment ordering manual recounts of ballots in the 2000 presidential election).

Brennan's contribution to constitutional super-protection for fundamental personal rights[14] (Brennan and Peckham as co-liberals?[15]).

Brennan unmistakably is liberal and a liberal champion, but the question remains: In exactly whose sense of this somewhat vagrant term is that so? We might look for further clues in either or both of two additional expansions by the authors, toward their book's end, of their characterization of Brennan as "the very embodiment of a liberal justice"[16]—those being Brennan's oratorical invocations of human dignity as a basis of rights[17] and his sponsorship of a "living constitution"[18] (or "moral reading"[19]) approach to constitutional interpretation. And yet the first could leave Brennan paired with Pope John Paul II,[20] while the second could leave him paired with Richard Epstein.[21]

There is only one way I can see to make all this come out right, and it does fit the theme of surprise.

Writing at a time when the Warren Court's doctrinal legacies still strongly guided the discourse and debates of the Supreme Court, political theorist and public intellectual Alan Ryan detected in the Court's body of work the stamp of the philosopher John Rawls. Rawls's ideas "have crept into the law of the land," Ryan wrote.[22]

> Liberal-minded lawyers keep pushing the envelope of the Constitution, trying to expand Americans' civil liberties, but they don't at the same time encourage the courts to favor the rights of property developers. One reason is that they have been taught [by Rawls] that liberal ideals of justice do embrace civil rights and economic equality but do not embrace laissez-faire and the unfettered rights of property.[23]

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14. *See* STERN & WERMIEL, *supra* note 1, at xiii (discussing Brennan's role in crafting a constitutional right to privacy).

15. *See* Lochner v. New York, 198 U.S. 45, 64 (1905) (holding that a New York law limiting the amount of hours a baker could work was an infringement on the right and liberty to contract, and therefore was unconstitutional).

16. STERN & WERMIEL, *supra* note 1, at 546.

17. *Id.* at 542.

18. *Id.* at 546.

19. *See* RONALD DWORKIN, FREEDOM'S LAW: THE MORAL READING OF THE AMERICAN CONSTITUTION 5 (1996) (calling Brennan a notably "liberal and explicit practitioner[] of the moral reading of the Constitution").

20. *See* Ioannes Paulus PP. II, *Evangelium Vitae* (Mar. 25, 1995), http://www.vatican.va/edocs/ENG0141/_INDEX.HTM (pronouncing the Catholic Church's position on the value of human life).

21. *Compare* RICHARD A. EPSTEIN, TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN v (1985) ("I argue that . . . clauses in the Constitution render constitutionally . . . suspect many . . . institutions of the twentieth century.") *with id.* at 3 ("This book is an extended essay about the proper relationship between the individual and the state.").

22. Alan Ryan, *How Liberalism, Politics Come to Terms*, WASH. TIMES, May 16, 1993, at B8.

23. *Id.*

Ryan thus identified Brennan and his judicial pals as "liberal" in a sense akin to what Rawlsian political philosophy has in mind. So, I now suggest, do Stern and Wermiel. Rawls's ideas, it seems—not just Rawls's, of course, but those of broadly allied theorists such as Joshua Cohen, Ronald Dworkin, Jürgen Habermas, Thomas Nagel, and T.M. Scanlon, to name just a few contemporary liberals whose programmatic views largely converge with Rawls's (even as these theorists may differ among themselves over aspects of the philosophical underpinnings)—are what our authors mean by "liberal," in effect if not by intention.

Academics will easily identify the group of philosophers I mean. They compose a contemporary group of liberals of a distinctively egalitarian type, all of whom would confess to inspiration, somewhere along the line (and by inspiration I do not mean detailed guidance) from the political–philosophical ideas of Immanuel Kant (along with, no doubt, those of John Locke, John Stuart Mill, and others). To their common philosophy, I suggest—to their "overlapping consensus"—the liberal profile by which our authors award the prize to Brennan's adjudicative works rather strikingly conforms.

Take it by steps. Start with the question of a fundamental-liberty right to physician-assisted suicide. Our group of philosophers finds that choice covered by a constitutionally protected right of people to decide for themselves matters "'central to personal dignity and autonomy.'"[24] So, surely, would Justice Brennan have found, given the chance.[25] What would distinguish the Justice and the philosophers as *liberal* in this instance might be their alliance with what has been called a "voluntarist" account of human dignity, as grounded in (roughly) the capacity of a being of the human kind for ethical and moral self-direction. The contrast would be with a "creationist" account (as we may call it) that grounds human dignity in a "'particular spiritual and bodily structure,'" or, in other words, in humanity's "place within a divinely established natural order."[26] It does not take much work to see how the two views might easily clash at the point of sorting out

24. *See* Ronald Dworkin, *Assisted Suicide: The Philosophers' Brief*, N.Y. REV. OF BOOKS, Mar. 27, 1997, at 41, 41 (quoting from the plurality opinion in *Planned Parenthood v. Casey*, 505 U.S. 833, 851 (1992)) (introducing and then reprinting an amicus brief on behalf of six philosophers, supporting a fundamental constitutional right to physician-assisted suicide)).

25. Brennan's tenure as Justice ended prior to the Supreme Court's decision in *Washington v. Glucksberg*, 521 U.S. 702 (1997). The evidence, however, is clear from dissenting opinions in *Cruzan v. Director, Mo. Dep't of Health*, 497 U.S. 261, 301–30 (1990) (Brennan, J., dissenting), and *Michael H. v. Gerald D.*, 491 U.S. 110, 136–57 (1989) (Brennan, J., dissenting). Brennan's *Cruzan* dissent refers repeatedly to Nancy Cruzan's claim to dignity. *See Cruzan*, 497 U.S. at 301, 302, 311 (arguing for Cruzan's right to choose to die with dignity, and citing language from the supreme courts of several states that expresses a similar concern for human dignity in a near-death medical care context).

26. Michael Rosen, Dignity 73–74 (unpublished manuscript) (on file with author) (quoting from Pope John Paul II, Encyclical, *Veritatis Splendor*, 23 ORIGINS 297, 312 (1993)).

the claims and obligations of individuals and the state in the context of assistance of suicide.

But of course liberalism in *that* sense could take in many philosophers who are decidedly *not* liberal in other respects obviously intended by Stern and Wermiel in their designation of Brennan as liberal champion. (Among the signers of the "Philosophers' Brief" we find Robert Nozick.)[27] And that takes us to a next step, for which the recent, sharply divisive *Citizens United*[28] can stand as icon. Kathleen Sullivan explains how the Court's decision there may be viewed as a triumph for a "libertarian" view of freedom of speech (serving as a negative check on state manipulation of the market in ideas), over an "egalitarian" view of this freedom (serving as a guarantor of political equality).[29] We know that Brennan-as-liberal would have stood with the speech-egalitarians.[30] But of course both the libertarian and egalitarian views are liberal in a broader and entirely familiar sense of the term. Both demand robust justification for any legislative restriction on political and much other speech. Only the egalitarian side, however, upholds promotion of equality of access to political debate as a proper regulatory aim.[31] In doing so, that side corresponds quite nicely with our contemporary strand of egalitarian-liberal political philosophy.[32]

Without running out the string, I suggest that the contemporary egalitarian/Kantian liberalism of Rawls et al. will, at just about every point in the profile, jibe neatly and suggestively with the authors' designation of Brennan (but presumably not Roberts, Rehnquist, Friedman, Hayek, Posner, Epstein, Peckham, or Nozick) as "liberal." And perhaps, there too, lies a surprise. Surprise, I mean, that 21st century journalistic authors, in a book so decidedly nonacademic and vernacular as *Justice Brennan*, should so unselfconsciously—one is tempted to say, so casually—have taken on board such a historically recent philosophical turn on the term "liberal" as the one

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27. *See* Dworkin, *supra* note 24; ROBERT NOZICK, ANARCHY, STATE, AND UTOPIA (1974).

28. Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876 (2010).

29. Kathleen M. Sullivan, *Two Concepts of Freedom of Speech*, 124 HARV. L. REV. 143, 144–45 (2010).

30. *See* Austin v. Mich. State Chamber of Commerce, 494 U.S. 652, 675 (1990) (Brennan, J., concurring) ("[T]he state surely has a compelling interest in preventing a corporation it has chartered from exploiting those who do not wish to contribute to the Chamber's political message."); FEC v. Mass. Citizens for Life, Inc., 479 U.S. 238, 263 (1986) (confirming "the legitimacy of Congress' [sic] concern that organizations that amass great wealth in the economic marketplace not gain unfair advantage in the political marketplace").

31. *See* Sullivan, *supra* note 29, at 154–55 (stating that egalitarians believe "political equality is advanced by governmental regulation limiting corporate incentives to decrease the diversification of electoral debate").

32. *See, e.g.*, JOHN RAWLS, POLITICAL LIBERALISM 359–63 (1993) (discussing how the fair value of political liberties is essential for a just political process, and how this might require restricting certain forms of speech in order to foster others); Ronald Dworkin, *The Curse of American Politics*, N.Y. REV. BOOKS, Oct. 17, 1996, at 19, 19 (criticizing disparate campaign financing for its negative impact on political equality).

represented by Rawls, Dworkin, Habermas et al. Those philosophers' ideas, it seems, have crept not just into the law of the land,[33] but into the most thoughtful talking heads of our civic culture—at least to the point of defining what "liberalism" is, if not, alas, to the point of cementing it as our civic religion.

We could try one further spin on the theme of surprise, by way of redeeming our authors' claim for Brennan's influence.[34] Once, while rejoining to Alan Ryan, I was wild enough to suggest a possible both-ways creep of ideas. The Warren Court reached its apogee in years during which John Rawls was bringing *A Theory of Justice* toward publication. Might it possibly be that the Warren Court's example crept into the heads of observant political philosophers?[35]

33. *See supra* note 22 and accompanying text.

34. *See supra* note 3 and accompanying text.

35. *See* Frank I. Michelman, *Rawls on Constitutionalism and Constitutional Law* (stating that Justices on the Warren Court, such as Brennan, "produced the basic doctrinal ingredients for a liberalized American constitutional law well before they or their law clerks could have heard of Rawls"), *in* THE CAMBRIDGE COMPANION TO RAWLS 394, 408 (Samuel Freeman ed., 2003).

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A Justice for All Seasons

JUSTICE BRENNAN: LIBERAL CHAMPION. By Seth Stern & Stephen Wermiel. Houghton Mifflin Harcourt. 2010. Pp. 688, $35.00.

Robert M. O'Neil*

There can be no serious question about the durability of Justice William J. Brennan's legacy on the Supreme Court. Any lingering doubt on that score has now been allayed by the publication of Stephen Wermiel's and Seth Stern's prodigious biography—long anticipated, but well worth the wait. After a quarter century in which lawyers, judges, journalists, and scholars have waited with mounting eagerness, the publication of *Justice Brennan: Liberal Champion*[1] fills a crucial gap in judicial biography. Other (and less distinguished) members of the high Court have long since received adequate attention and recognition. Yet curiously the preeminent jurist of the latter half of the twentieth century has, until now, remained accessible only through relatively superficial accounts that have been both uneven and unbalanced.[2] The reasons for such long delay are well known, and have recently been amplified by several interviews in popular and legal media, and by authors' forums.

Yet the origins of this extraordinary partnership merit brief comment. In the mid-1980's, Justice Brennan tapped then-*Wall Street Journal* Supreme Court reporter Stephen Wermiel to be his official biographer; though others had eagerly sought that honor, Wermiel was the Justice's enthusiastic choice to assume this daunting task. Not only was he given unprecedented access to the Justice's confidential papers and personal insights (notably through candid conversations even before Brennan's retirement from the Court in 1990),[3] but thereafter continued to probe with a degree of access that few other biographers could have hoped. When the Justice annually gathered his present and former clerks for a dinner at or near the Court, Wermiel and the few

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1. SETH STERN & STEPHEN WERMIEL, JUSTICE BRENNAN: LIBERAL CHAMPION (2010).

2. *See Book Review of JUSTICE WILLIAM J. BRENNAN, JR.: FREEDOM FIRST*, PUB. WKLY., Aug. 1, 1994, (stating that "this book lacks substantive reflections by Brennan and a biographical report on the forces shaping his life"); *CHOICE'S* OUTSTANDING ACADEMIC TITLES: 1998–2002: REVIEWS OF SCHOLARLY TITLES THAT EVERY LIBRARY SHOULD OWN 547–48 (Rebecca Ann Bartlett ed., 2003) (noting that biographers usually describe Brennan in a very saintly manner, presumably as opposed to an objective manner).

3. *See* Adam Liptak, *Brennan Book, Many Years in Making*, N.Y. TIMES, Oct. 5, 2010, at A14 (quoting Wermiel as saying that he conducted interviews of Brennan in his chambers and stating that Wermiel had access to everything present in the chambers).

members of his immediate family alone were invited. Each clerk got from the Justice an unambiguous request to respond candidly and fully to Wermiel's questions and probing personal interviews. None of those clerks seem ever to have demurred, much less dissimulated. Indeed, the exhaustive array of footnotes and references attest eloquently to that process.

After two decades, however, it became clear that the Brennan biography would not soon emerge without collaboration. Indeed, apprehension in the '90s that premature publication while the Justice lived might embarrass him eventually vanished, only to be replaced by growing concern of an opposite sort—that not only would his legacy be obscured, but that vast amounts of invaluable data and insights might simply vanish. Happily, to the rescue came Seth Stern, a recent Harvard Law School graduate and journalist on the Congressional Quarterly staff. Stern simply continued and accelerated the process, completing substantial portions of the text and mining the vast archives of pertinent material. Wermiel, meanwhile, assumed full co-authorship while teaching at the American University Law School and completed several later chapters needed to conclude the biography.

The process leading to this achievement was both meticulous and expansive. Two potentially slighted incidents may illustrate. President Eisenhower, who enthusiastically tapped Brennan for the Court in the fall of 1956, is widely reputed to have responded (when asked if he has ever made any mistakes), "Yes: two. And they are both sitting on the Supreme Court."[4] Exhaustive research now reveals that Eisenhower (despite some ambivalence about the jurisprudence of both Earl Warren and William Brennan) never made such a quip, widely quoted though it has been over the years.[5] Moreover, the authors stress the constituency of White House endorsement for Brennan's selection—further undermining the superficial notion that the President haphazardly chose a liberal Eastern Catholic to enhance poll numbers in the coming election.[6] That Ike may have entertained doubts—even serious doubts—about the wisdom of his choice for the Court seems probable. But that was a far cry from "two [mistakes] . . . on the Supreme Court" from a President who soon thereafter cut Senator McCarthy off at the knees over his rabid anti-Communism.

The other revealing incident involved a very different issue, but reflected comparable care and precision on the authors' part. For the first decade or so after he joined the Court, Justice Brennan chose his clerks exclusively from the Harvard Law School. Some had previously clerked for lower court judges while others came straight to Washington. But they had to a man (and they were all men) served three years in Cambridge, specifically on the Law Review. And all had been vetted by the eminent constitutional scholar and eloquent Solicitor General, Professor Paul Freund.

4. STERN & WERMIEL, *supra* note 1, at 139.
5. *Id.*
6. *Id.* at 79–80.

By the late '60s the Justice notified several of his early clerks that he had decided to break the lock-step by inviting non-Harvard clerks—especially those in the federal Third Circuit (which was his own). He was especially receptive to Pennsylvania grads (from the Justice's own undergraduate alma mater). He also invited nominations from former clerks who were now establishing themselves in law teaching. Some commotion ensued, including disparagement of the Justice's wider casting of the net. The clear implication was that Freund, long the sole kingmaker, had somehow fallen out of favor, along with the Law School.[7] Here again Wermiel and Stern tracked down the rumor, refuted it, and got it right. There were some strains and tensions between the Justice and Langdell Hall in those years, but his personal ties with Professor Freund as a revered classmate remained most cordial—as any later clerk would attest from constant encomia that flowed from Cambridge to Washington.[8]

Despite the appropriately chronological flow of *Justice Brennan: Liberal Champion*, a striking value of the book is the authors' capacity to distill areas of emphasis that transcend chronology. Several areas or topics receive special attention. The Justice's role as judicial colleague clearly stands out, and for reasons developed in the book. Especially notable was his capacity to craft tenuous majorities for important civil rights and liberties long before Justice Goldberg joined the Court in 1962 and thus for the first time provided a predictable fifth vote.[9] The process by which in these six early years he managed to entice colleagues like Justice Stewart, Justice Harlan or even occasionally Justice Clark was truly remarkable.[10]

No less striking was the denouement of that process, in the waning years after a new and far less congenial Chief Justice took over the reins. Quite simply, Justice Brennan never abandoned his quest for collegial support even at the darkest hour, finding potential allies like Justice Scalia and Justice Kennedy in unlikely places.[11] (And, while recalling his uncanny jurisprudential strategy, Wermiel and Stern thoughtfully address the often-

7. *Id.* at 204.

8. *Id.* at 292.

9. *See id.* at 156 (describing how Justice Brennan created a majority in *Irvin v. Dowd*, 359 U.S. 397 (1959), by persuading Justice Stewart to join his opinion by writing a more narrow draft of the opinion); *id.* at 183 ("The case [*Baker v. Carr*, 369 U.S. 186 (1962)] showed Brennan at his best as a tactician and coalition builder, but also highlights his willingness to sacrifice the quality of an opinion's legal reasoning to get the outcome he wanted.").

10. *See id.* at 136 (recounting that Justice Brennan personally called a Harlan clerk into his chambers to discuss his views on *Speiser v. Randall*, 357 U.S. 513 (1958), giving the clerk "ammunition" to use in inducing Justice Harlan to join the opinion); *id.* at 156 ("Brennan did eventually win over Stewart [in *Irvin v. Dowd*], by writing a narrow opinion allowing Irvin to pursue his habeas corpus claim in federal court."); *id.* at 188 (discussing Justice Brennan's willingness to visit Justice Clark during a snowstorm in order to persuade him to join the majority opinion in *Baker v. Carr*).

11. *See e.g.*, *id.* at 526 ("The six justices who agreed with Brennan that flag burning was a form of expressive conduct protected by the First Amendment included O'Connor, Kennedy, and, perhaps most surprisingly, Scalia.").

bandied charge of judicial vote swapping by a Justice whose political instincts and insights were masterful, but hardly descended to the tactics of the Newark ward boss who was his father).[12]

Beyond collegiality, mention should surely be made of Justice Brennan's role as mentor. The authors marveled at his unique capacity to recall at annual dinners the names and current roles of each of what eventually became 115 clerks.[13] Indeed, well beyond reciting name and Term, he recalled without notes at least one major case on which each of his clerks had worked while on the Court. And though he often deferred heavily to his clerks in the drafting of high court opinions (some would charge, unfairly and inaccurately, that the clerks actually "wrote" the opinions), his exquisite care was as legendary as his picture-perfect penmanship. During a luncheon discussion with an unusually irreverent clerk for another Justice, Brennan was challenged about a seemingly trivial natural gas-regulation case. The presumptuous clerk continued, pressing the Justice about footnotes, which the drafter of the opinion assumed had never been vetted on their way to the printer. As the anxious drafter should have expected, the Justice simply smiled, and added, "Well, Dick, if you'd read to the next sentence in that footnote you'd realize just how we relied on the statute in that case." And lest perplexing questions about the Justice's puzzling rejection of two putative and promising law clerks—Michael Tigar and Alison Grey Anderson—remain after reading *Liberal Champion*, the co-authors candidly and fairly address both matters. Indeed, they offer fresh and welcome insights on both apparent slights, noting the eventual rapprochement in Tigar's case,[14] and offering an unusually perceptive explanation of the unrequited slight in Anderson's case.[15]

This incident closely followed one in which the Justice reviewed a draft of a minor statutory case, asking about a specific footnote declaration that the prior case was now to be formally "overruled." The Justice asked which member of the Court had written the about-to-be-abandoned precedent. The clerk promptly identified the author as Justice Tom Clark. Noting that, "Tom's still on the Court so we don't need to overrule," Brennan immediately drew a line through the "overruling" language and (in his immaculate script) wrote "we thus distinguish" the cited cases, adding to the stunned clerk, "Now you figure out just how we distinguish them." So much, one might infer, for potentially marginal use of stare decisis.

12. *See id.* at 464 ("The book's depiction fed the public perception that Brennan operated in the Court like a savvy Irish ward boss, a notion that he always resented. . . . Brennan asked that [his biographer] 'kill off that silly notion of an amiable Irishman going around cajoling and maybe seducing colleagues . . . .'").

13. *See id.* at 247 (describing Justice Brennan's remarkable memory).

14. *See id.* at 273–74 (describing the friendship that developed between Justice Brennan and Tigar in the late 1970's).

15. *See id.* at 388 (explaining that Justice Brennan "felt more comfortable around men" and worried that he could not have the same "relaxed rapport" with a female clerk).

Collegiality, as the co-authors note consistently in their account of Justice Brennan's relationship with his judicial colleagues, appeared in myriad dimensions, though always with grace and often with humor as well.

Happily, Wermiel and Stern have created a chronological structure into which observations about Justice Brennan's life—both personal and professional—fit comfortably. The authors have been entirely realistic about the limitations of an ultimately imperfect "champion"—devoting adequate and important coverage to such challenges as the first Mrs. Brennan's illness[16] and alcoholism on one hand,[17] and on the other hand the family's persistent penury.[18] If there remains any serious qualification to the scope and accuracy of the personal side of the Justice's life story, it may lie in the inevitable reliance upon family recollections and impressions from an earlier time, but now for obvious reasons well beyond verification. With the passing of Marjorie Brennan, later of his son Bill, III, and eventually of Mary Fowler Brennan (who had for many years been the Justice's secretary and eventually his second wife), there seems to have been almost by default an undue reliance on Nancy Brennan as the sole actively involved family survivor.[19] Inevitably, her perceptions and impressions seem to have become dominant in the absence of contrary family and collegial insights. Despite the extraordinary care and accuracy with which *Liberal Champion* captured the essence of the person and the judge, one such caution may be warranted.

The co-authors contend admirably with the accuracy of characterizations such as "liberal" and "First Amendment champion" among others, on which volumes have been written about the Justice's jurisprudence. Wermiel and Stern wisely approach those questions with care and caution, for they are fully aware of many unresolved issues of constitutional law and policy on everything ranging from race to gender to federal preemption, due process, abortion, and well beyond. Many volumes have been written about the merits of such issues, with ample attention to Justice Brennan's singular role. Perhaps an appropriate exit strategy for a brief review would be to recall the nearly unanimous judgment of the Justice's eventually 115 Supreme Court clerks, to the inevitable question: "If you had only one chance, which of his decisions would you be most eager to overrule?" Few votes would have been cast for anything other than *Roth v.*

16. *Id.* at 323–29 (discussing the discovery of and surgery on Marjorie Brennan's advanced throat cancer).

17. *See id.* at 205–06 ("Marjorie [Brennan] was almost certainly exhibiting the symptoms of alcoholism by the early 1960s.").

18. *See, e.g., id.* at 320–21 (chronicling a period of financial strain following Justice Brennan's decision to cut ties with all organizations except for the Court and the Catholic Church, thereby forgoing income from speaking engagements).

19. *See, e.g., id.* at 206 (describing how Nancy speculated that Justice Brennan's inability to help those closest to him with their personal problems contributed to his resolve to help the poor and defenseless from the bench).

United States,[20] the obscenity opinion he crafted so early in his years on the Court. Unanimous castigation invariably follows the mere mention of the case. Yet the authors remind us that such obvious factors as a Roman Catholic background, or a moderate view on personal and family matters, or a desire to evince early commitment to non-liberal values, fail to explain so contentious a precedent—long and fervently repudiated though it would be in the ensuing years. Thus one should read *Liberal Champion* with full realization of the limitations and imperfections of its subject, but with no lesser measure of admiration both for the Justice and for the long-sought but most-welcome biography.

One poignant incident may offer a benediction. Just days after his death in June, 1997, President Bill Clinton delivered the Justice's eulogy in St. Matthew's Cathedral. Reading from a text that clearly had been drafted by an aide, Clinton lauded several notable Brennan rulings on core constitutional issues. "Think of it, today the votes of all Americans have equal weight because of Justice Brennan." Rising to the challenge, Clinton continued: "The press can freely and robustly debate the great issues of the day because of Justice Brennan." Realizing just in time a need to qualify this last encomium, the President quickly departed from his script and added an aside. "Mr. Justice, you'll have to forgive the elected officials here if, from time to time, we have doubted the wisdom of that decision, . . . which probably proves it's correct."[21] Looking straight at the coffin, Clinton reaffirmed just in time his abiding commitment along with due process. Beyond any doubt, at that final moment, the Justice's legacy remained unblemished in the eyes of a fellow constitutional scholar.

20. 354 U.S. 476 (1957).

21. President Bill Clinton, Eulogy for Justice Brennan (July 29, 1997) (audio recording available at *Justice Brennan Eulogies*, C-SPAN VIDEO LIBRARY, http://www.c-spanvideo.org/program/Eul).

Selective Judicial Activism

JUSTICE BRENNAN: LIBERAL CHAMPION. By Seth Stern & Stephen Wermiel. Houghton Mifflin Harcourt. 2010. Pp. 688, $35.00.

Geoffrey R. Stone*

When the term "judicial activist" was first coined by Arthur Schlesinger, Jr. in 1947, it "did not have a derogatory connotation."[1] By the time William J. Brennan, Jr. had completed his thirty-four years on the Supreme Court, the phrase had become a pejorative, implying the irresponsible exercise of judicial authority.

Critics on and off the Court have vilified Brennan and his liberal colleagues for their activism. In 1966, the political scientist Robert McCloskey accused Brennan and his fellow "judicial activists" of creating "Constitutional rules out of whole cloth."[2] Judge Learned Hand complained that the "judicial activists" on the Supreme Court were acting like "a bevy of Platonic guardians."[3] Anthony Lewis reported that critics had vehemently attacked "judicial activists" like Brennan for "taking too much joy" in their own power and "trying too boldly to fix up the wrongs of our system."[4] And Justice Felix Frankfurter castigated the "judicial activists" for making decisions on the basis of "'their prejudices and their respective pasts and self-conscious desires to join Thomas Paine and T. Jefferson in the Valhalla of "liberty."'"[5] To this day, no Supreme Court nominee—not Anthony Kennedy, not Ruth Bader Ginsburg, not John Roberts, not Elena Kagan—has dared to describe him or herself as a "judicial activist." Such a self-characterization would certainly be the kiss of death for any nominee.

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1. SETH STERN & STEPHEN WERMIEL, JUSTICE BRENNAN: LIBERAL CHAMPION 232 (2010).

2. *Id.* at 232–33 (quoting Robert G. McCloskey, *Reflections on the Warren Court*, 51 VA. L. REV. 1229, 1259 (1965)).

3. *Id.* at 231 (quoting LEARNED HAND, THE BILL OF RIGHTS: THE OLIVER WENDELL HOLMES LECTURES 1958, at 73 (1958)).

4. *Id.* at 231 (quoting Anthony Lewis, *Supreme Court Moves Again to Exert Its Powerful Influence*, N.Y. TIMES, June 20, 1964, at E3).

5. *Id.* at 102 (quoting Melvin I. Urofsky, *Conflict Among the Brethren: Felix Frankfurter, William O. Douglas and the Clash of Personalities and Philosophies on the United States Supreme Court*, 1988 DUKE L.J. 71, 105 (1988)).

Is the pejorative "judicial activist" warranted? To answer that question, we must begin with the Court's economic substantive due process decisions in cases like *Lochner v. New York*,[6] half a century before William Brennan joined the Court. *Lochner* and its progeny, which held unconstitutional a broad range of progressive legislation regulating such matters as maximum hours and minimum wages, represented a highly controversial form of *conservative* judicial activism. Over time, *Lochner*, the *bête noire* of progressives of that era, came to be "one of the most condemned cases in United States history."[7]

Critics of the *Lochner*-era jurisprudence took away two quite distinct lessons. Some, like Frankfurter, concluded that judicial activism was presumptively illegitimate and unwarranted. The only principled stance for a responsible Justice was one of judicial restraint. As Seth Stern and Stephen Wermiel aptly observe, "Frankfurter believed firmly that judges should act with restraint and largely defer to the elected branches."[8] Indeed, this was "something he had preached as a professor at a time when a conservative Supreme Court was overturning the progressive economic regulations . . . that he favored."[9] It was for this reason that Frankfurter was so condemning of his "judicial activist" colleagues on the Court.

Other critics of *Lochner*, like Hugo Black, William O. Douglas, and William Brennan, took away a very different lesson. In their view, *Lochner* was wrong not because judicial activism is wrong, but because *Lochner* was not an appropriate case for judicial activism. It was this view that Chief Justice Harlan Fiske Stone set forth in 1938 in his famous footnote 4 in *United States v. Carolene Products Co.*[10] While burying the doctrine of economic substantive due process, Stone at the same time suggested that "[t]here may be narrower scope for operation of the presumption of constitutionality when legislation . . . restricts those political processes which can ordinarily be expected to bring about repeal of undesirable legislation," or when it discriminates "against discrete and insular minorities" in circumstances in which it is reasonable to infer that prejudice, intolerance, or indifference might seriously have curtailed "the operation of those political processes ordinarily to be relied upon to protect minorities . . . ."[11]

It was this conception of *selective* judicial activism that shaped Brennan's jurisprudence. It is important to emphasize that, Frankfurter to the contrary notwithstanding, this view of the judicial role is not necessarily the product of individual Justices' personal "prejudices" and experiences.

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6. 198 U.S. 45 (1905).
7. BERNARD H. SIEGAN, ECONOMIC LIBERTIES AND THE CONSTITUTION 23 (1980).
8. STERN & WERMIEL, *supra* note 1, at 101.
9. *Id.*
10. 304 U.S. 144 (1938).
11. *Id.* at 152–53 n.4.

Rather, it is deeply rooted in the original understanding of the purpose of judicial review in our system of constitutional governance.

The Framers of our Constitution wrestled with the problem of how to cabin the dangers of an overbearing or intolerant majority. For example, those who initially opposed a bill of rights argued that such a list of rights would serve little, if any, practical purpose, for in a self-governing society the majority could simply disregard whatever rights might be "guaranteed" in the Constitution. In the face of strenuous objections from the Anti-Federalists during the ratification debates, however, it became necessary to reconsider the issue.

On December 20, 1787, Thomas Jefferson wrote James Madison from Paris that, after reviewing the proposed Constitution, he regretted "the omission of a bill of rights."[12] In response, Madison expressed doubt that a bill of rights would "provide any check on the passions and interests of the popular majorities."[13] He maintained that "experience proves the inefficacy of a bill of rights on those occasions when its controul is most needed. Repeated violations of these parchment barriers have been committed by overbearing majorities in every State" that already had a bill of rights.[14] In such circumstances, he asked, "What use . . . can a bill of rights serve in popular Governments?"[15]

Jefferson replied, "Your thoughts on the subject of the Declaration of rights" fail to address one consideration "which has great weight with me, the legal check which it puts into the hands of the judiciary. This is a body, which if rendered independent . . . merits great confidence for their learning & integrity."[16] This exchange apparently carried some weight with Madison. On June 8, 1789, Madison proposed a bill of rights to the House of Representatives. At the outset, he reminded his colleagues that "the greatest danger" to liberty was found "in the body of the people, operating by the majority against the minority."[17] Echoing Jefferson's letter, he stated the position for judicial review, contending that if these rights are:

> incorporated into the constitution, independent tribunals of justice will consider themselves . . . the guardians of those rights; they will be an impenetrable bulwark against every assumption of power in the legislative or executive; they will be naturally led to resist every

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12. Letter from Thomas Jefferson to James Madison (Dec. 20, 1787), *reprinted in* JACK N. RAKOVE, DECLARING RIGHTS: A BRIEF HISTORY WITH DOCUMENTS 154, 156 (1998).

13. RAKOVE, *supra* note 12, at 159.

14. Letter from James Madison to Thomas Jefferson (Oct. 17, 1788), *reprinted in* RAKOVE, *supra* note 12, at 160, 161.

15. *Id.* at 162.

16. Letter from Thomas Jefferson to James Madison (Mar. 15, 1789), *reprinted in* RAKOVE, *supra* note 12, at 165, 165.

17. James Madison, Speech to the House of Representatives (June 8, 1789), *reprinted in* RAKOVE, *supra* note 12 at 170, 177.

> encroachment upon rights expressly stipulated for in the constitution by the declaration of rights.[18]

This reliance on judges, whose lifetime tenure would hopefully insulate them from the need to curry favor with the governing majority, was central to the Framers' understanding. Alexander Hamilton, for example, strongly endorsed judicial review as obvious and uncontroversial. The "independence of the judges," he reasoned, is "requisite to guard the Constitution and the rights of individuals from the effects of those ill humours, which ... sometimes disseminate among the people themselves" Judges, he insisted, have a duty to resist invasions of constitutional rights even if they are "instigated by the major voice of the community."[19]

It was this "originalist" conception of judicial review that informed Justice Brennan's selective judicial activism. As a rule, he gave a great deal of deference to the elected branches of government—except when he felt such deference would effectively abdicate the responsibility the Framers had imposed upon the Judiciary to serve as an essential check against the inherent dangers of democratic majoritarianism. He therefore invoked activist judicial review primarily in two situations: (1) when the governing majority systematically disregarded the interests of a historically underrepresented group (such as blacks, ethnic minorities, political dissidents, religious dissenters, women, and persons accused of crime), and (2) when there was a risk that a governing majority was using its authority to stifle its critics, entrench the status quo, and/or perpetuate its own political power.

Because Brennan played so central a role in crafting many of the key decisions of the Warren Court, it may be useful to note just a few of those decisions to illustrate my point. Consider, for example, *Brown v. Board of Education*,[20] which prohibited racial segregation in public schools; *Loving v. Virginia*,[21] which invalidated laws forbidding interracial marriage; *Engel v. Vitale*,[22] which prohibited school prayer; *Goldberg v. Kelly*,[23] which guaranteed a hearing before an individual's welfare benefits could be terminated; *Reynolds v. Sims*,[24] which guaranteed "one person, one vote"; *Miranda v. Arizona*,[25] which gave effect to the prohibition of compelled self-incrimination; *Gideon v. Wainwright*,[26] which guaranteed all persons accused of crime the right to effective assistance of counsel; *New York Times v.*

18. *Id.* at 179.
19. THE FEDERALIST NO. 78 (Alexander Hamilton).
20. 347 U.S. 483 (1954).
21. 388 U.S. 1 (1967).
22. 370 U.S. 421 (1962).
23. 397 U.S. 254 (1970).
24. 377 U.S. 533 (1964).
25. 384 U.S. 436 (1966).
26. 372 U.S. 335 (1963).

Sullivan,[27] which limited the ability of public officials to use libel actions to silence their critics; and *Elfbrandt v. Russell*,[28] which protected the First Amendment rights of members of the Communist Party. Each of these decisions clearly reflected the central purpose of judicial review—to guard against the greatest dangers of majoritarian abuse.[29]

By definition, antimajoritarian decisions generally do not sit well with the majority. It is therefore hardly surprising that this jurisprudence excited biting criticism, especially in the political arena, where candidates curry favor with that very same majority. By the late 1960s, Richard Nixon was able to make the Court's "judicial activism" a significant issue in national politics. During his nomination acceptance speech in 1968, for example, he insisted that the Court had "gone too far in weakening the peace forces as against the criminal forces in this country and we must act to restore that balance."[30] Nixon decried the activism of the Warren Court and pledged to appoint "strict constructionists" rather than "judicial activists" to the Court. In the discourse of the time, a strict constructionist was a judge committed to judicial restraint. In a few short years, Nixon appointed Warren Burger, Harry Blackmun, Lewis Powell, and William Rehnquist to the Court. Although these Justices varied over time in their adherence to "strict constructionism," their presence quickly transformed the Court, leaving Justice Brennan in the minority for the rest of his tenure.

The change in the Court's role since 1968 has been dramatic. In the twenty-five years between 1968 and 1993, shortly after Brennan left the Court, Republican presidents made *twelve* consecutive appointments to the Supreme Court. According to research by Lee Epstein, William Landes, and Richard Posner, in 1968 the average voting record of the five most liberal Justices (Marshall, Douglas, Brennan, Fortas, and Warren) in civil liberties cases was .185. (This is on a scale in which .000 is the most liberal and 1.000 is the most conservative.) The swing Justice was Earl Warren, whose voting record was .263.[31] By 1993, after twelve consecutive Republican

27. 376 U.S. 254 (1964).

28. 384 U.S. 11 (1966).

29. Many of these decisions reflected, indirectly if not directly, the "gravitational pull" of the quest for racial justice and equality. *See* Burt Neuborne, *The Gravitational Pull of Race on the Warren Court*, 2010 SUP. CT. REV. (forthcoming 2011) (manuscript at 9–27) (on file with Texas Law Review) (arguing that race exercised a strong influence on the Warren Court's federalism, separation of powers, and First Amendment jurisprudence); HARRY KALVEN, JR., THE NEGRO AND THE FIRST AMENDMENT 4 (1965) (arguing that recent constitutional decisions relating to race and free speech challenge the law's prior conceptions of racial equality).

30. Richard M. Nixon, Presidential Nomination Acceptance Speech (Aug. 8, 1968) (transcript available at http://www.presidency.ucsb.edu/ws/index.php?pid=25968).

31. *See* LEE EPSTEIN, WILLIAM M. LANDES AND RICHARD A. POSNER, ARE JUDGES REALISTS? AN EMPIRICAL STUDY tbl.3-2 (forthcoming HARV. L. REV. 2011); *see also* Geoffrey R. Stone, *Understanding Supreme Court Confirmations*, 2010 SUP. CT. REV. (forthcoming 2011) (manuscript at 21) (on file with Texas Law Review).

appointments, the average voting record of the five most conservative Justices (Thomas, Rehnquist, Scalia, O'Connor, and Kennedy) was .798, and the swing Justice, Anthony Kennedy, had a voting record of .695.[32] Thus, the Court majority was roughly as conservative in 1993 as it had been liberal in 1968. Even more striking, by 1993 the "liberals" on the Court were almost as conservative as the "conservatives" on the Court in 1968.[33]

But what does "conservative" mean in the modern era? In Nixon's time, the term meant a Justice committed to judicial restraint. But beginning with the Reagan era, this began to change. Justices like Antonin Scalia, Clarence Thomas, John Roberts, and Samuel Alito are anything but restrained. Rather, like Justice Brennan, they employ a form of *selective* judicial activism. On the one hand, it seems clear that these Justices would have joined few, if any, of the Warren Court decisions I mentioned earlier. On the other hand, though, despite all the conservative rhetoric about "strict constructionism," "originalism," "judicial restraint," and "call[ing] balls and strikes,"[34] these conservative Justices have been just as activist as their liberal predecessors, but in a wholly different set of cases.

In a series of unmistakably activist decisions, the conservative Justices have held unconstitutional affirmative action programs,[35] gun control regulations,[36] limitations on the authority of corporations to spend at will in the political process,[37] restrictions on commercial advertising,[38] laws prohibiting groups like the Boy Scouts from discriminating on the basis of sexual orientation,[39] federal legislation regulating guns, age discrimination,

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32. EPSTEIN ET AL., *supra* note 31.

33. The four conservatives in 1968 (Harlan, White, Stewart, and Black) had an average voting record of .521, whereas the four liberals in 1993 (Stevens, Souter, Blackmun, and White) had an average voting record of .436. *See* EPSTEIN, LANDES & POSNER, *supra* note 31, at tbl.3-2.

34. *Confirmation Hearing on the Nomination of John G. Roberts, Jr. to Be Chief Justice of the United States: Hearing Before the S. Comm. on the Judiciary*, 109th Cong. 56 (2005) (statement of John G. Roberts, Jr., Supreme Court C.J. Nominee).

35. *See* Parents Involved in Cmty. Sch. v. Seattle Sch. Dist. No. 1, 551 U.S. 701, 747–78 (2007) (holding unconstitutional an affirmative action program that took race into account when determining school placement).

36. *See* McDonald v. City of Chi., 130 S. Ct. 3020, 3050 (2010) (holding that the Second Amendment is applicable to the states and remanding the case for further proceedings); D.C. v. Heller, 554 U.S. 570, 595, 635 (2008) (holding that D.C.'s ban on handgun possession in the home violated the individual right to bear arms conferred by the Second Amendment).

37. *See* Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876, 913 (2010) (holding that "[t]he First Amendment does not permit Congress to make . . . categorical distinctions based on the corporate identity of the speaker and the content of the political speech").

38. *See* Thompson v. W. States Med. Ctr., 535 U.S. 357, 376–77 (2002) ("If the Government's failure to justify its decision to regulate speech were not enough to convince us that the FDAMA's advertising provisions were unconstitutional, the amount of beneficial speech prohibited by the FDAMA would be. . . . [W]e affirm the . . . judgment that the speech-related provisions . . . are unconstitutional.").

39. *See* Boy Scouts of Am. v. Dale, 530 U.S. 640, 661 (2000) (overturning application of a state public accommodations law that would have prohibited discrimination based on sexual orientation).

the environment, and violence against women,[40] and policies of the State of Florida relating to the outcome of the 2000 presidential election.[41]

Nothing about this jurisprudence smacks of "judicial restraint." To the contrary, it has about it the distinctive air of Platonic guardianship. The challenge is to figure out what theory of judicial review or constitutional law drives this particular form of activism. Although one can readily discern the specific conception of judicial review that undergirds Justice Brennan's use of judicial activism, which is clearly rooted in the concerns of Jefferson, Madison, and Hamilton, no similar principle of judicial review or constitutional methodology explains the jurisprudence of contemporary conservative judicial activists. To understand Brennan's theory of activist judicial review, all one needs to do is to look at the *results* and then ask, "Why these cases and not others?" If one attempts the same inquiry of the decisions of the current conservative Justices, however, no principled explanation emerges for their version of selective activism. Rather, to return to Justice Frankfurter's ill-tempered observation, the selective activism of Justices like Scalia, Thomas, Roberts, and Alito seems to be born out of "'their prejudices and their respective pasts and self-conscious desires to join [Ronald Reagan and George W. Bush] in the Valhalla of "liberty."'"[42] The point, in other words, is that judicial activism itself is neither inherently good nor inherently bad. It is a legitimate and essential method of constitutional interpretation when used in *appropriate* circumstances.

I sometimes wonder what constitutional law might look like today if Justices with the same vision as Justice Brennan had remained a majority on the Supreme Court over the past forty years. It is not so difficult to imagine such a state of affairs. Had Hubert Humphrey defeated Richard Nixon, Jimmy Carter defeated Ronald Reagan, or Al Gore defeated George W. Bush, the path of constitutional law might have been very different. What is more difficult to imagine is how constitutional law might have evolved in that counterfactual universe. It has been so long since there has been a liberal majority on the Court that it is difficult even to conceive what a liberal jurisprudence might look like today.

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40. *See* Printz v. United States, 521 U.S. 898, 933 (1997) (holding that "[t]he mandatory obligation imposed on CLEOs to perform background checks on prospective handgun purchasers plainly runs afoul of [the law]"); Kimel v. Fla. Bd. of Regents, 528 U.S. 62, 91 (2000) (holding "that the [Age Discrimination in Employment Act] is not a valid exercise of Congress' power"); Solid Waste Agency v. United States Army Corps of Eng'rs, 531 U.S. 159, 174 (2001) (holding a federal law claiming jurisdiction over ponds and mudflats was unconstitutional); United States v. Morrison, 529 U.S. 598, 627 (2000) (holding that a federal law dealing with violence against women was not constitutional).

41. *See* Bush v. Gore, 531 U.S. 98, 103 (2000) (invalidating Florida's "use of standardless manual recounts" as violative of the "Equal Protection and Due Process Clauses").

42. STERN & WERMIEL, *supra* note 1, at 102 (quoting Melvin I. Urofsky, *Conflict Among the Brethren: Felix Frankfurter, William O. Douglas and the Clash of Personalities and Philosophies on the United States Supreme Court*, 1988 DUKE L.J. 71, 105).

Here are some possibilities: the counterfactual Court might have held, not that affirmative action is unconstitutional, but that it is sometimes constitutionally required; it might have held, not that cigarette companies have a constitutional right to shill their products to children,[43] but that children have a constitutional right to an adequate and equal education;[44] it might have held not that silence constitutes waiver of the right to remain silent,[45] but that individuals accused of a crime have a constitutional right to DNA testing; it might have held, not that the government can constitutionally ban partial birth abortions,[46] but that it cannot constitutionally ban stem-cell research in order to enforce the faith-based beliefs of the religious right; it might have held, not that corporations have a constitutional right to spend millions to buy the elected representatives of their choice,[47] but that public officials cannot constitutionally use partisan gerrymandering to ensure their perpetuation in power;[48] it might have held, not that the Boy Scouts have a constitutional right to discriminate against gays and lesbians,[49] but that gays and lesbians have a constitutional right to marry.

Constitutional interpretation is not a mechanical, value-free enterprise. It requires judges to exercise judgment. It calls upon them to consider text, history, precedent, values, and ever-changing social and cultural conditions. It requires restraint, wisdom, empathy,[50] and intelligence. Perhaps above all, it requires a recognition of the Judiciary's unique strengths and weaknesses and a deep and accurate understanding of our nation's most fundamental constitutional aspirations.

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43. *See* Lorillard Tobacco Co. v. Reilly, 533 U.S. 525, 566 (2001) (holding that regulations on tobacco advertising violate the First Amendment because they fail *Central Hudson*'s four-part analysis).

44. *See* San Antonio Indep. Sch. Dist. v. Rodriguez, 411 U.S. 1, 54–55 (1973) (holding that the Texas system of financing public education rationally furthers a legitimate state purpose or interest and therefore satisfies the Equal Protection Clause).

45. *See* Berghuis v. Thompkins, 130 S. Ct. 2250, 2264 (2010) (holding that unless a suspect explicitly invoked his *Miranda* rights he waived them by making voluntary statements and that police did not have to obtain a waiver of the suspect's *Miranda* rights before interrogating him).

46. *See* Gonzales v. Carhart, 550 U.S. 124, 168 (2007) (holding that the Partial-Birth Abortion Ban Act of 2003 was not unconstitutional on its face).

47. *See* Citizens United v. Fed. Election Comm'n, 130 S. Ct. 876, 913 (2010) (holding that "[t]he First Amendment does not permit Congress to make . . . categorical distinctions based on the corporate identity of the speaker and the content of the political speech").

48. *See* Vieth v. Jubelirer, 541 U.S. 267, 281 (2004) (holding that "political gerrymandering claims are nonjusticiable" because there are no "judicially discernable and manageable standards for adjudicating political gerrymandering claims").

49. *See* Boy Scouts of America v. Dale, 530 U.S. 640, 644 (2000) (holding that applying New Jersey's public accommodations law to require the Boy Scouts to readmit an avowed homosexual and gay rights activist violated the Boy Scouts' First Amendment right of expressive association).

50. Richard Cotton, one of Justice Brennan's law clerks in the Court's 1972 term, observed that Brennan "had the ability to see a case through the eyes of the people involved." STERN & WERMIEL, *supra* note 1, at 206.

As Justice Brennan himself observed, the Supreme "'Court is not a council of Platonic guardians given the function of deciding our most difficult and emotional questions according to the Justices' own notions of what is just or wise or politic.'"[51] Rather, "'our government structure assigns to the people's elected representatives the function of making policy for handling the social and economic problems of state and nation'" and "'the impropriety of a judiciary with life tenure writing its own social and economic creed into the Constitution is therefore clear.'"[52] At the same time, though, Brennan insisted that "'[j]ust as an individual may be untrue to himself, so may society be untrue to itself.'"[53] The Court's responsibility in interpreting and applying the Constitution, he rightly insisted, is to "'keep the community true to its own fundamental principles.'"[54]

51. *Id.* at 233 (quoting Justice William James Brennan, The U.S. Constitution, Speech at Maxwell Air Force Base (Sept. 9, 1963), *reprinted in* 2 AIR WAR C. SUPPLEMENT 3, 43).

52. *Id.* (quoting *A Visit with Justice Brennan*, LOOK, Dec. 18, 1962).

53. *Id.* at 234 (quoting Justice William James Brennan, Bouton Lecture at Princeton University (Feb. 4, 1969)).

54. *Id.*

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Notes

Worth Another Look: Net-Worth Discovery Standards in Texas*

"[T]he current Texas rule on net-worth discovery is now decades-old and, in light of the evolution of Texas law, needs to be revisited."[1]

I. Introduction

The above quote represents a common sentiment among Texas lawyers charged with discovering an opponent's net worth or defending against such discovery.[2] Under Texas law, a defendant's net worth is discoverable in cases in which exemplary damages may be recovered. For over twenty years, Texas judges and lawyers have operated under this broad statement of the law with little additional guidance. Despite many judicial opinions in this area, we are still left with the question: What constitutes net worth? Out of necessity, courts have begun formulating their own tests to determine what materials are relevant to a defendant's net worth. Because lower courts have received little guidance, it is not surprising that the amount of information a party is entitled to see or required to divulge is largely dependent upon which of the fourteen Texas districts the case is filed in. This inconsistent application of the law will continue until the Texas Supreme Court intervenes.

In this Note, I address the net-worth debate and offer a solution to some of the problems. I do so in six parts. Part II details the evolution of Texas law in this area. After initially allowing discovery of a broad range of materials, courts have begun limiting the amount of discoverable

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* I am grateful to Professor Alex Albright for her helpful guidance in developing this Note. Thanks also to the wonderful staff of the Texas Law Review, particularly Serine Consolino, Jamie France, Chris Granaghan, and Sarah Hunger, as well as Tracey Bamberger and Omar Ochoa for all of their hard work editing this Note. I would also like to thank my parents, Serapio and Debra Arguijo, and my brothers, Serapio Jr. and Tommy, for supporting me throughout law school. Most of all, I thank my wife, Margaret, who has given me so much more than I deserve.

1. *In re* Jacobs, 300 S.W.3d 35, 47–48 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (Sullivan, J., concurring).

2. *See* R. Michael Northrup & Melinda R. Newman, *In Search of Consensus on "Net Worth,"* 22 APP. ADVOC. 235, 235–40 (2010) (recognizing that "a uniform definition of 'net worth' has not yet been realized" and cataloging attempts by the Texas legislature and intermediate courts to come up with answers); Eric G. Walraven, *Why Do You Need to Know What I Have? It Is Time for a New Standard Regarding the Discoverability of Net Worth*, 20 APP. ADVOC. 271, 271 (2008) (arguing that the Texas Supreme Court needs "to provide much needed guidance as to when sensitive net worth information should be produced in a lawsuit"); Mike Northrup, *Discovery of Net Worth Continues to Simmer*, REVERSE & RENDER (Oct. 28, 2009), http://www.reverseandrender.com/2009/10/articles/opinions-judgments/discovery-of-net-worth-continues-to-simmer/ (opining that the issue of net-worth discovery "may have simmered long enough in the courts of appeals and it may be time to reexamine it").

information. Many courts have now formulated their own tests regarding net worth, the most common of which relies upon Generally Accepted Accounting Principles (GAAP). Part III analyzes the GAAP approach to net-worth discovery. In many ways, GAAP appears to offer the best solution to the inconsistency in this area of the law. A more in-depth look at the policy justifications for allowing net-worth discovery in exemplary-damage cases, however, reveals GAAP's shortcomings. Part IV examines the policy justifications and concerns regarding net-worth discovery. Net-worth discovery is intrusive. Concerns about privacy, however, cannot end the discussion. Instead, they must be balanced against the policy justification for exemplary damages: punishment. Part V offers a solution regarding the proper standard for net-worth discovery, and Part VI concludes.

II. History of Net-Worth Discovery in Texas

Under Texas law, a defendant's net worth is relevant to a case in which exemplary damages may be recovered.[3] Because net worth is relevant, it is discoverable.[4] The Texas Supreme Court announced this broad rule in 1988, and since that time, lower courts and attorneys have struggled to determine the exact contours of the rule. This Part details the history behind the Texas Supreme Court's decision and examines the differing lower court responses.

A. Lunsford v. Morris

In *Lunsford v. Morris*,[5] the Texas Supreme Court announced a new rule regarding discovery of a defendant's net worth in exemplary-damage cases. *Lunsford* reached the Texas Supreme Court by way of a writ of mandamus after both the trial court and appellate court denied Lunsford's request for discovery.[6] Lunsford had brought suit against his former employer for "conspiracy and malicious defamation."[7] In connection with this claim, Lunsford "sought both actual and punitive damages."[8] Because he sought punitive damages, Lunsford requested the "production of financial statements and other documents bearing on the defendants' net worth."[9] The trial court

3. TEX. CIV. PRAC. & REM. CODE § 41.011(a)(6) (West 2010). The terms *exemplary damages* and *punitive damages* are synonymous. *See id.* § 41.001(5) ("'Exemplary damages' means any damages awarded as a penalty or by way of punishment but not for compensatory purposes. Exemplary damages are neither economic nor noneconomic damages. 'Exemplary damages' includes punitive damages."). Because the Texas statutory scheme refers to exemplary damages, I will use that term throughout this Note.

4. *See* TEX. R. CIV. P. 192.3 ("In general, a party may obtain discovery regarding any matter that is not privileged and is relevant to the subject matter of the pending action . . . .").

5. 746 S.W.2d 471 (Tex. 1988), *disapproved on other grounds by* Walker v. Packer, 827 S.W.2d 833 (Tex. 1992).

6. *Id.* at 471.

7. *Id.*

8. *Id.*

9. *Id.*

denied the request by relying on the century-old precedent of *Young v. Kuhn*.[10]

In analyzing Lunsford's request, the Texas Supreme Court took note of the "overwhelming authority" for allowing discovery of net-worth information in connection with exemplary damages.[11] Particularly, the court found that at least forty-three jurisdictions allowed discovery of net worth in exemplary-damage cases at the time of the case.[12] In light of this authority to the contrary, the court developed a new rule for net-worth discovery, overruling *Young* in the process.[13] Specifically, the court found that a "defendant's 'ability to pay' bears directly on the question of adequate punishment and deterrence."[14] As a result, the court held that "in cases in which punitive or exemplary damages may be awarded, parties may discover and offer evidence of a defendant's net worth."[15]

In announcing this new rule, the *Lunsford* court provided two clarifications regarding the rule's implementation. First, the court held that plaintiffs are not required to pass any "evidentiary threshold" regarding the underlying exemplary-damage claim.[16] Some states require plaintiffs to

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10. 9 S.W. 860 (Tex. 1888); *see also* Gerald Reading Powell & Cynthia A. Leiferman, *Results Most Embarrassing: Discovery and Admissibility of Net Worth of the Defendant*, 40 BAYLOR L. REV. 527, 528 (1988) (mentioning the trial court's reliance upon *Young*). In *Young*, the Texas Supreme Court declined to allow discovery of net worth in exemplary-damage cases, stating,

> [I]t would be strange indeed if such a rule ought to be applied in an action sounding in damages in which a defendant, not as compensation for an injury inflicted, but as punishment, may be mulcted in exemplary damages. A rule which makes the true basis for damages not the injury inflicted, but the ability of the offending person to pay, to our minds finds no sanction in principle, and, if applied, would lead to results most embarrassing in the administration of justice.

Young, 9 S.W. at 862. This decision would govern net-worth discovery in Texas for the next one hundred years.

11. *Lunsford*, 746 S.W.2d at 472.

12. *Id.* at 472 & n.2.

13. *Id.* at 472–73.

14. *Id.* at 472.

15. *Id.* at 473. This holding was later codified in section 41.011 of the Texas Civil Practice and Remedies Code, which provides that a court "shall" consider evidence relating to a defendant's net worth, among other factors, in the calculation of an exemplary-damage award. TEX. CIV. PRAC. & REM. CODE § 41.011 (West 2010).

16. *Lunsford*, 746 S.W.2d at 473. Courts have consistently relied upon this statement of the law to reject arguments by defendants who seek to require plaintiffs to make some showing of entitlement to exemplary damages before discovery. *See, e.g.*, *In re* Jacobs, 300 S.W.3d 35, 40–41 (Tex. App.—Houston [14th Dist.] 2009, no pet.) ("[A] party seeking discovery of net-worth information need not satisfy any evidentiary prerequisite, such as making a prima facie showing of entitlement to punitive damages, before discovery of net worth is permitted."); *In re* House of Yahweh, 266 S.W.3d 668, 673 (Tex. App.—Eastland 2008, no pet.) ("A party seeking discovery of net worth information is not required to make a prima facie showing of a right to recover exemplary damages before discovery is permitted."); *In re* Garth, 214 S.W.3d 190, 192–93 (Tex. App.—Beaumont 2007, pet. dism'd) (declining to hold that the trial court abused its discretion in requiring the defendant to disclose net-worth information before the plaintiff showed a prima facie right to exemplary damages). Some commentators have argued that requiring plaintiffs to cross an

make a prima facie showing of entitlement to exemplary damages before being allowed to discover net-worth information.[17] The *Lunsford* court refused to require such a showing, however, reasoning that "[o]ur rules of civil procedure and evidence do not require" it.[18] Specifically, the court noted that Texas rules of procedure allow discovery of "any 'relevant' matter; thus, there is no evidentiary threshold a litigant must cross before seeking discovery."[19]

Secondly, the court made clear that it was not circumscribing the trial court's authority "to consider on motion whether a party's discovery request involves unnecessary harassment or invasion of personal or property rights."[20] By not affecting the trial court's ability to protect defendants from unnecessary discovery, the court provided defendants with a safeguard from the broad discovery requests that were sure to come after the *Lunsford* holding.

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evidentiary threshold before allowing them to discover net-worth materials would be a proper solution to the concerns about the intrusiveness of this type of discovery. *See, e.g.*, Walraven, *supra* note 2, at 272–75 (noting that Texas is one of the few jurisdictions in the United States that does not require some showing of entitlement to exemplary damages before a court allows net-worth discovery and arguing that the Texas Supreme Court should require a prima facie showing of entitlement before a court allows net-worth discovery in order to "properly balance a plaintiff's right to discover relevant information with a defendant's right to privacy"). The Texas Supreme Court was poised to make a decision on this issue, but the parties ultimately settled before oral arguments. *See* Mike Northrup, *Just Say "No" to Net Worth*, REVERSE & RENDER (Aug. 16, 2010), http://www.reverseandrender.com/tags/in-re-jacobs/ (lamenting the Texas Supreme Court's dismissal of a case that would have addressed the net-worth issue). Regardless of how the evidentiary-threshold debate turns out, the question of what materials are discoverable whenever that discovery is allowed will remain. Thus, rather than address the evidentiary-threshold question, this Note's analysis proceeds based on the current state of the law—that plaintiffs are not required to pass any evidentiary threshold before discovery.

17. *See, e.g.*, Larriva v. Montiel, 691 P.2d 735, 736 (Ariz. Ct. App. 1984) ("We have found the general rule to be that there must be prima facie proof of a defendant's liability for punitive damages before his wealth or financial condition may be discovered."); Leidholt v. District Court in & for City of Denver, 619 P.2d 768, 770–71 (Colo. 1980) (holding that the "need for discovery must be balanced by weighing the defendant's right to privacy and protection from harassment . . . against the plaintiff's right to discover information" and imposing on plaintiffs "the burden of establishing a *prima facie* right to punitive damages" before discovery is allowed); Bryan v. Thos. Best & Sons, Inc., 453 A.2d 107, 108 (Del. 1982) (finding a "naked allegation" of entitlement to punitive damages insufficient to warrant discovery of net-worth information and requiring plaintiffs to "lay a factual foundation establishing that it is reasonably likely that a triable issue as to defendant's liability for punitive damages exists" before discovery is allowed).

18. *Lunsford*, 746 S.W.2d at 473. The Texas discovery rules have been updated and restructured since *Lunsford*. The *Lunsford* court was operating under what was then Rule 166b(2). *Id.* The substance of then Rule 166b(2) is currently codified as Texas Rule of Civil Procedure 192. Because the substance of the rule did not change with the restructuring, the restructuring does not affect the *Lunsford* holding.

19. *Id.* (citing TEX. R. CIV. P. 166b(2)(a)). Although a party does not have to cross any evidentiary threshold to discover net-worth information, a party is still required to allege a sufficient factual basis to justify an exemplary-damages award. Al Parker Buick Co. v. Touchy, 788 S.W.2d 129, 130–31 (Tex. App.—Houston [1st Dist] 1990, no writ).

20. *Lunsford*, 746 S.W.2d at 473.

Despite these additional clarifications, not all of the justices were convinced the court had gone far enough to clarify the ruling. Justice Raul Gonzalez dissented from the opinion, arguing that the court had "planted the seeds of confusion that [would] result in years of litigation as practitioners and the bench [strove] to comply with this opinion."[21] Particularly, Justice Gonzalez was concerned with the uncertainty surrounding the term *net worth*.[22] Although the court mentioned net worth eighteen times in the opinion, the court "failed to inform the bench and bar what 'net worth' is or how it should be calculated."[23] By way of example, Justice Gonzalez illustrated the uncertainty that would face both the bench and bar:

> Is a single balance sheet sufficient to identify "net worth" or is additional financial information necessary? . . . How do we measure net worth? Do we prove "net worth" by profit and loss statements, income tax returns, cash liquidity, a Fortune 500 listing, Standard & Poor's rating, and the like? . . . Without objective criteria, a case by case determination will undoubtedly yield a wide disparity of results.[24]

Justice Gonzalez's concerns proved prescient in the early years after *Lunsford* as courts tried to determine what materials and timeframe were relevant to net worth.

B. Broad Discovery and Uncertainty

In the immediate aftermath of *Lunsford*, courts generally permitted discovery of a wide range of materials,[25] sometimes despite the court's own misgivings about the rule it was enforcing. For example, in *Hanna v. Meurer*,[26] the defendants sought to prevent depositions seeking "information regarding their net worth and . . . financial and personnel records."[27] They argued on mandamus review that the discovery request involved "unnecessary harassment or invasion of personal or property rights."[28] In analyzing the defendant's arguments, the court stated, "Although we may agree with the thrust of relators' argument and share their concerns, this

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21. *Id.* at 474 (Gonzalez, J., dissenting).

22. *Id.* at 475.

23. *Id.*

24. *Id.*

25. *See, e.g.*, Delgado v. Kitzman, 793 S.W.2d 332, 333–34 (Tex. App.—Houston [1st Dist.] 1990, no writ) (allowing discovery of ten years of income tax returns); Hanna v. Meurer, 769 S.W.2d 680, 681 (Tex. App.—Austin 1989, no writ) (allowing the plaintiffs to depose the defendants "to discover information regarding [the defendant's] net worth and to obtain information and financial and personnel records"); Miller v. O'Neill, 775 S.W.2d 56, 58–59 (Tex. App.—Houston [1st Dist.] 1989, no writ) (overturning an order denying the production of eleven years of both individual and partnership tax returns).

26. 769 S.W.2d 680 (Tex. App.—Austin 1989, no writ).

27. *Id.* at 681.

28. *Id.*

Court is bound, of course, by the supreme court's pronouncement on the law until that court states otherwise."[29]

Courts not only allowed discovery of a broad range of materials but also materials from a broad range of time. In *Miller v. O'Neill*,[30] the defendant sought a protective order preventing the production of *eleven years* of income tax returns and "financial and/or net worth statements" on the grounds that the requests were overbroad, harassing, an invasion of privacy, and "not relevant and not likely to lead to the discovery of relevant evidence."[31] The trial court granted the protective order without hearing any testimony regarding its necessity.[32] On mandamus review, however, the First District Court of Appeals granted the writ, stating that "the pretrial discovery of a defendant's net worth is not precluded, but is mandated."[33] Because the defendant had presented no evidence to the trial court to support his claim that the requests were overbroad, harassing, or an invasion of privacy, the court held that the trial court abused its discretion in granting the order.[34]

C. *Limitations on Discovery*

After four years of courts upholding broad discovery requests, the Texas Supreme Court imposed its first limitation on the discovery of net-worth information in *Sears, Roebuck & Co. v. Ramirez*.[35] Sears had appealed a trial court order requiring it to produce "annual reports and tax returns for the five years preceding [the] suit."[36] Sears agreed to produce the annual reports "but objected to the request for production of tax returns on the grounds of undue burden and unnecessary expense."[37] Sears responded to the discovery request by "providing its audited and certified annual reports" and an affidavit stating "that the annual reports accurately reflect[ed] Sears' net worth."[38] Because there was no indication to the contrary, the Texas Supreme Court agreed that the annual reports provided an accurate reflection of Sears's net worth.[39] More importantly, however, the court held Sears's tax returns were not discoverable because there was "no justification for requiring Sears to produce the same information in different form."[40] Though the denial was based on traditional discovery objections—undue burden and duplicity—*Sears* represents one of the first appellate decisions to

29. *Id.*
30. 775 S.W.2d 56 (Tex. App.—Houston [1st Dist.] 1989, no writ).
31. *Id.* at 57.
32. *Id.*
33. *Id.* at 58.
34. *Id.* at 59.
35. 824 S.W.2d 558 (Tex. 1992).
36. *Id.* at 559.
37. *Id.*
38. *Id.*
39. *Id.*
40. *Id.*

place limits on the discoverable materials. In the years after *Sears*, courts began to take a more aggressive approach to limiting net-worth discovery.

1. Time Restrictions.—One way courts began to limit the amount of discoverable information was to restrict the timeframe considered relevant for discovery purposes.[41] In *In re House of Yahweh*,[42] the Eastland District Court of Appeals addressed an order compelling the production of tax returns, donation records, and other financial records.[43] The court found the request to be overbroad because it included balance sheets from the previous four years.[44] Specifically, the court held that "earlier balance sheets would not be relevant to relators' *current* net worth."[45] Because earlier balance sheets were not relevant, the court held that the trial court should have limited the discovery to documents sufficient to show current net worth, including "any current balance statements."[46]

2. Calculation Restrictions.—Courts have also begun formulating tests that have limited the amount of discoverable net-worth information. For example, in *In re Jacobs*,[47] the Fourteenth District Court of Appeals analyzed a trial court order requiring two physicians to disclose either financial statements they had provided to a lender showing each physician's assets and liabilities or an affidavit in the format of what would have been provided to a lender regarding each physician's net worth.[48] Additionally, the trial court ordered the physicians to be present "for deposition regarding their net worth."[49] The defendants sought mandamus review from both orders.[50]

On appeal, the court limited the trial court's orders in two ways: (1) the court held that two years was too broad in scope for the discovery[51] and

41. *See* Northrup & Newman, *supra* note 2, at 237 ("In the exemplary damage context, at least three courts of appeal have concluded that only *current* net worth is relevant, and those courts precluded discovery of older balance sheets.").

42. 266 S.W.3d 668 (Tex. App.—Eastland 2008, no pet.).

43. *Id.* at 673–74. The requested financial records included property lists, bank statements, stock ownership statements, asset lists, income and budget forecasts, evaluations of financial performance, correspondence relating to profitability, and balance sheets. *Id.*

44. *Id.* at 673.

45. *Id.* (emphasis added).

46. *Id.* at 673–74; *see also In re* Jacobs, 300 S.W.3d 35, 44–45 (Tex. App.—Houston [14th Dist.] 2009, no pet.) ("[T]he trial court abused its discretion by ordering the relators to produce net-worth information beyond the relators' *current* net worth." (emphasis added)). In *Jacobs*, the court defined "current" to mean "as of the time the discovery is responded to, though net-worth information should be updated through supplementation—as should the information in any discovery response—if it changes materially between the service of the discovery response and the time of trial." *Id.* at 44 n.9.

47. 300 S.W.3d 35 (Tex. App.—Houston [14th Dist.] 2009, no pet.).

48. *Id.* at 39.

49. *Id.*

50. *Id.*

51. *Id.* at 44–45.

(2) the court narrowed "the scope of oral-deposition inquiry into net worth."[52] In limiting the scope of oral-deposition inquiry, the court held that the plaintiffs were

> limited to asking each physician to state (1) his or her current net worth, i.e., the amount of current total assets less current total liabilities determined in accordance with generally accepted accounting principles . . . and (2) the facts and methods used to calculate what each physician alleges is his or her current net worth.[53]

In reaching this definition of net worth, the court noted that neither the Texas Supreme Court nor the legislature has defined net worth.[54] In seeking to provide the parties with a clear definition of net worth, the court looked to other areas of the law where net worth is relevant. Specifically, the court noted that net worth is used "to ascertain the amount of security required to suspend a judgment pending appeal" and is defined in that area "in accordance with GAAP."[55] As a result, the court relied on this GAAP-based definition to narrow the scope of discovery.

III. GAAP-Based Discovery

Use of the GAAP approach to net-worth discovery is a recent development.[56] In many ways, GAAP appears to provide a solution to the uncertainty that has plagued courts since *Lunsford*. Additionally, use offal in other areas of Texas law supports its use in exemplary-damage cases. It is far from clear, however, that GAAP addresses all of the relevant concerns inherent to net-worth discovery. This Part analyzes the advantages and disadvantages of the GAAP approach and concludes that GAAP is not the best solution to Texas's net-worth discovery problems.

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52. *Id.* at 46. The court also rejected the defendants' arguments that plaintiffs needed to prove prima facie entitlement to exemplary damages before they could get discovery and that plaintiffs had failed to allege sufficient facts to support a gross negligence finding. *Id.* at 40–44; *see also supra* note 16 and accompanying text.

53. *In re* Jacobs, 300 S.W.3d at 46.

54. *Id.* at 46 n.11.

55. *Id.* (citing Ramco Oil & Gas, Ltd. v. Anglo Dutch (Tenge) L.L.C., 171 S.W.3d 905, 914 (Tex. App.—Houston [14th Dist.] 2005, no pet.)); *see also infra* section III(A)(1). The court also referenced *Black's Law Dictionary*, which defines *net worth* as "[a] measure of one's wealth, usu. calculated as the excess of total assets over total liabilities." BLACK'S LAW DICTIONARY 1639 (8th ed. 2004).

56. *See Jacobs*, 300 S.W.3d at 46 n.11 (defining net worth in accordance with GAAP); *In re* Garth, 214 S.W.3d 190, 193 (Tex. App.—Beaumont 2007, pet. dism'd) (finding that it was an abuse of discretion for the trial court to order the disclosure of materials that "would generally show only the asset side of the net worth equation"); Northrup & Newman, *supra* note 2, at 235–37 (discussing intermediate court use of the GAAP-based definition of net worth).

A. Advantages of GAAP

GAAP is used in a number of areas of the law.[57] The beauty of using GAAP comes from the proposed clarity and consistency it brings. GAAP can be described as a rules-based system.[58] As such, GAAP "usually call[s] for black-and-white solutions."[59] For an area of law that has been marred with uncertainty, GAAP is capable of providing a solution.[60] Texas courts' analysis regarding supersedeas bonds is illustrative of the benefits GAAP can bring.

1. Net-Worth Determinations in Supersedeas Bonds.—A supersedeas bond protects a judgment debtor from having a judgment enforced against him while he appeals the judgment.[61] Generally, a judgment creditor may seek to enforce a civil money judgment by "obtaining a judgment lien and execution on a debtor's property."[62] If the debtor wants to appeal the judgment, however, the debtor can post a supersedeas bond.[63] This bond will stay the "execution on a judgment during the pendency of the appeal."[64]

Texas courts are responsible for calculating the proper amount of the bond.[65] A court's discretion in setting the amount, however, is limited by the statutory requirement that "the amount of security must not exceed the lesser of: (1) 50 percent of the judgment debtor's net worth; or (2) $25 million."[66] Similar to the exemplary-damage statute, net worth is not defined in the supersedeas-bond statute. In defining net worth for supersedeas bonds, the Fourteenth District Court of Appeals recently implemented the GAAP

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57. *See, e.g.*, Michael Gaddis, Note, *When Is a Dog Really a Duck?: The True-Sale Problem in Securities Law*, 87 TEXAS L. REV. 487, 490–92 (2008) (explaining the SEC's use of GAAP in SEC determinations of whether a transaction "may be accounted for as a sale"); *infra* notes 62–68 and accompanying text.

58. *See* John C. Coffee, Jr., *Understanding Enron: "It's About the Gatekeepers, Stupid,"* 57 BUS. LAW. 1403, 1416–17 (2002) ("Enron has shown that we have a 'rules-based' system of accounting . . . ."); Omar Ochoa, Note, *Filling the "GAAP": Why Generally Accepted Accounting Principles Should Inform U.C.C. Article 9 Decisions*, 89 TEXAS L. REV. 207, 212 (2010) ("GAAP is often criticized as being a rules-based system.").

59. Ochoa, *supra* note 58, at 212.

60. *See generally id.* (advocating the use of GAAP to help determine whether a transaction is a lease or a security interest for U.C.C. Article 9 purposes).

61. BLACK'S, *supra* note 55, at 190.

62. Elaine A. Carlson, *Reshuffling the Deck: Enforcing and Superseding Civil Judgments on Appeal After House Bill 4*, 46 S. TEX. L. REV. 1035, 1040 (2005).

63. *Id.*

64. BLACK'S, *supra* note 55, at 190.

65. TEX. CIV. PRAC. & REM. CODE § 52.006 (West 2010). An appellate court will "review the alleged excessiveness of the trial court's determination of the amount of security under Rule 24.4 of the Texas Rules of Appellate Procedure using an abuse-of-discretion standard." Ramco Oil & Gas, Ltd. v. Anglo Dutch (Tenge) L.L.C., 171 S.W.3d 905, 909 (Tex. App.—Houston [14th Dist.] 2005, no pet.).

66. CIV. PRAC. & REM. § 52.006(b). A trial court also cannot set an amount that will cause the judgment debtor "substantial economic harm." *Id.* § 52.006(c).

standard:[67] the court held that the plain meaning of net worth is assets minus liabilities.[68]

The Fourteenth District's use of GAAP highlights the benefits a GAAP analysis can bring. Calculating the proper security amount requires precision. The statute provides precise levels that a bond cannot exceed—either 50% of net worth or $25 million. General estimates of a judgment debtor's net worth are insufficient in determining whether a bond has exceeded the statutory levels. Instead, GAAP's rules-based, black-and-white calculations are necessary to ensure compliance with the statute. Thus, the certainty GAAP provides coupled with the precision Texas law requires makes GAAP an appropriate standard in the supersedeas-bond context. Net-worth discovery in exemplary-damage cases, however, presents different concerns.

B. Inappropriateness of GAAP in Net-Worth Discovery

The concerns that make GAAP an appropriate solution for supersedeas bonds do not apply to exemplary-damage cases. First, the precision required for supersedeas bonds is not present in the exemplary-damage statute. Secondly, in exemplary-damage cases, the protection that a GAAP approach would provide to defendants is inconsistent with the policy behind awarding exemplary damages: punishment.

1. The Statutory Language for Exemplary Damages Provides for a More Fluid Analysis.—Section 41.011 of the Texas Civil Practice and Remedies Code governs evidence relating to the amount of an exemplary-damage award.[69] That section provides that "[i]n determining the amount of exemplary damages, the trier of fact shall consider evidence, if any, *relating to*: . . . the net worth of the defendant."[70] This general language is a stark contrast to the precision required for supersedeas bonds. Additionally, the other exemplary-damage factors that a trier of fact shall consider are not

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67. *See Ramco*, 171 S.W.3d at 914 (using the definition of net worth in accordance with GAAP to determine the appropriate amount of security for a supersedeas bond).

68. *Id.* The court cited multiple dictionaries and other cases for support of GAAP's definition of net worth. *Id.* at 913–14; *cf.* Cont'l Web Press, Inc. v. NLRB, 767 F.2d 321, 323 (7th Cir. 1985). In addressing the problem of the undefined term *net worth* in the Equal Access to Justice Act, the Seventh Circuit stated,

> Congress did not define the statutory term "net worth." It seems a fair guess that if it had thought about the question, it would have wanted the courts to refer to generally accepted accounting principles. What other guideline could there be? Congress would not have wanted us to create a whole new set of accounting principles just for use in cases under the Equal Access to Justice Act. The proceeding to recover attorney's fees under the Act is intended to be summary; it is not intended to duplicate in complexity a public utility commission's rate of return proceeding.

Id. at 323.

69. CIV. PRAC. & REM. § 41.011.

70. *Id.* § 41.011(a) (emphasis added).

conducive to exact measurement or calculation: "(1) the nature of the wrong; (2) the character of the conduct involved; (3) the degree of culpability of the wrongdoer; (4) the situation and sensibilities of the parties concerned; and (5) the extent to which such conduct offends a public sense of justice and propriety."[71] Instead, these factors are meant to provide the trier of fact with different considerations to weigh in determining how severely to punish the defendant.

GAAP's rules-based, black-and-white approach is inconsistent with the amorphous nature of the exemplary-damage statute. Implementing a GAAP standard limits the amount of information a party is required to divulge. All that is necessary under a GAAP approach is a balance sheet showing assets and liabilities. The plain language of the statute, however, does not provide for a limitation of information—it provides for expansion. Many things "relate to" a defendant's net worth,[72] and the trier of fact is required to consider all of them under the statute. By taking a strictly GAAP approach, a court prevents the trier of fact from considering all of the relevant factors. The exemplary-damage statute requires a fluid analysis that GAAP alone is incapable of providing.

Additionally, the protection that GAAP would provide defendants by limiting the amount of discoverable information is inconsistent with the policy justification for awarding exemplary damages. These competing policy concerns—punishing the defendant versus protecting a defendant's privacy—are at the heart of the net-worth problems courts have faced. Because the competing policy concerns are central to the net-worth debate, they will be addressed in the next Part.

IV. Competing Policy Concerns

A common argument in favor of limiting net-worth discovery is grounded in protecting defendants. Net-worth discovery is intrusive. It requires a defendant to release personal financial information that is generally unavailable in other contexts. The justification for allowing discovery of this information, however, is less concerned with defendant privacy and more

71. *Id.*

72. *See, e.g.*, 29 C.F.R. § 4062.4 (2009) (providing that a "person's net worth is equal to its fair market value" and listing a number of factors to serve as the basis for determining fair market value); 16 TEX. ADMIN. CODE § 72.40 (2008) (Tex. Dep't of Licensing & Regulation, Proof of Net Worth) (listing a number of factors that a person applying for an original license can use to demonstrate the person's net worth, including: financial statements, federal tax returns, or a letter of credit); *cf.* Pension Benefit Guar. Corp. v. Diamond Reo Trucks, Inc., 509 F. Supp. 1191, 1195 (W.D. Mich. 1981) (holding that the broad language of the net-worth provisions in ERISA "demonstrates a congressional intent to require the PBGC to disdain mechanical formulae in favor of adopting flexible standards whereby an employer's true ability to sustain the expense of . . . liability may be measured").

concerned with punishing the defendant.[73] Thus, what materials are discoverable can only be determined by weighing these competing policies. This Part analyzes the competing arguments in this area and concludes that recent limitations on the amount of information a defendant is required to disclose have gone too far.

A. Arguments in Favor of Limiting Net-Worth Discovery

Courts and commentators rely on two sources of law to justify protecting defendants from intrusive net-worth discovery: (1) basic discovery principles and (2) recent tort-reform limitations on exemplary damages.

1. Basic Discovery Principles.—Texas trial courts have discretion in determining the proper scope of discovery.[74] That discretion, however, is limited by the rules of procedure.[75] Under rule 194.2, a trial court should limit discovery when

> (a) the discovery sought is unreasonably cumulative or duplicative, or is obtainable from some other source that is more convenient, less burdensome, or less expensive; or
>
> (b) the burden or expense of the proposed discovery outweighs its likely benefit, taking into account the needs of the case, the amount in controversy, the parties' resources, the importance of the issues at stake in the litigation, and the importance of the proposed discovery in resolving the issues.[76]

Both of these provisions have been used to justify limitations on discovery.[77] The first provision requires a more case-specific analysis. How duplicative or cumulative the materials are will depend on the materials requested by the plaintiff. The second provision, however, can be used to justify a principled limitation on net-worth discovery generally.

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73. To clarify, the justification for allowing broad discovery is not that the discovery itself punishes the defendant. Instead, the discovery is a mechanism to ensure that a jury can impose an adequate punishment. Discovery allows a plaintiff to properly assess the defendant's net worth and put evidence in front of the jury to ensure that the jury's exemplary-damage award reflects an amount the defendant is capable of paying. Limiting discovery necessarily limits the amount of evidence for a jury to see, which hampers the jury's ability to ensure that the exemplary-damage award is proper in scope. *See infra* section IV(B)(3).

74. *In re* CSX Corp., 124 S.W.3d 149, 152 (Tex. 2003); *In re* Jacobs, 300 S.W.3d 35, 44–45 (Tex. App.—Houston [14th Dist.] 2009, no pet.).

75. *CSX Corp.*, 124 S.W.3d at 152.

76. TEX. R. CIV. P. 192.4.

77. *See Jacobs*, 300 S.W.3d at 48–51 (Sullivan, J., concurring) (arguing that trial courts should focus on a "benefit-to-burden analysis" when making decisions regarding net-worth discovery); *In re* Garth, 214 S.W.3d 190, 194 (Tex. App.—Beaumont 2007, pet. dism'd) (denying discovery of "additional information showing only assets" because the trial court had already "required the production of certain financial statements regarding the individual's net worth").

2. Potential Burdens.—Because net-worth discovery is generally unique to exemplary-damage cases,[78] it presents unique burdens. First, the inherent tension between plaintiffs' needs and defendants' concerns can result in unnecessary "satellite litigation" over discovery disputes. This satellite litigation can produce "expense and burden far exceeding any potential benefit."[79] The litigation in *Jacobs* provides an example. In *Jacobs*, the injury in the underlying lawsuit occurred in September 2004.[80] Five years later, the appellate court was deciding a discovery dispute, and the merits of the actual case had still not been reached.[81] During that five-year period, the plaintiffs made "an exhaustive request for financial records covering a multi-year period," and the defendants responded with "a flood of objections."[82] The "level of chaos" in the case caused Judge Sullivan to question "the efficacy of this process as well as the relative value of the discovery in question."[83] The potential for (or likelihood of)[84] protracted discovery disputes gives courts an additional consideration in assessing the burdens associated with net-worth discovery.

Courts must also consider the inherent intrusiveness of net-worth discovery as an additional burden. Generally, "evidence of a party's wealth is irrelevant and prejudicial."[85] As a result, "it is almost always inadmissible at trial."[86] In exemplary-damage cases, however, evidence of net worth is not just allowed to be considered by the jury—it is required.[87] Bringing a defendant's financial affairs into the case raises the possibility of abusive and harassing discovery requests.[88] This "sort of invasive discovery generally raises very serious privacy concerns."[89]

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78. *See Jacobs*, 300 S.W.3d at 48 (Sullivan, J., concurring) ("As a general rule, evidence of a party's wealth is irrelevant and prejudicial."); Carter v. Exxon Corp., 842 S.W.2d 393, 399 (Tex. App.—Eastland 1992, writ denied) ("Testimony concerning the wealth or poverty of a party is ordinarily inadmissible in a civil case.").

79. *Jacobs*, 300 S.W.3d at 48 (Sullivan, J., concurring).

80. *Id.*

81. *Id.*

82. *Id.*

83. *Id.*

84. There was nothing unique about the *Jacobs* case to make discovery necessarily more difficult. Instead, *Jacobs* was simply "a tort case with themes common to many such disputes." *Id.*

85. *Id.*; *see also* Carter v. Exxon Corp., 842 S.W.2d 393, 399 (Tex. App.—Eastland 1992, writ denied) ("Testimony concerning the wealth or poverty of a party is ordinarily inadmissible in a civil case.").

86. *Jacobs*, 300 S.W.3d at 48 (Sullivan, J., concurring); *see also* Cooke v. Dykstra, 800 S.W.2d 556, 562 (Tex. App.—Houston [14th Dist.] 1990, no writ) ("Testimony concerning the wealth . . . of a party is ordinarily inadmissible . . . .").

87. *See* TEX. CIV. PRAC. & REM. CODE § 41.011(a)(6) (West 2010) ("In determining the amount of exemplary damages, the trier of fact *shall* consider evidence, if any, relating to: . . . the net worth of the defendant." (emphasis added)).

88. Walraven, *supra* note 2, at 275.

89. *Jacobs*, 300 S.W.3d at 51 (Sullivan, J., concurring).

Thus, the potential burdens to the court system and to defendants raise unique concerns for courts to consider when reviewing net-worth discovery requests. These burdens, however, are only dispositive if they outweigh the benefits from the discovery.

3. Lack of Benefits.—Those in favor of limiting net-worth discovery argue that it brings minimal benefits. For example, net worth is not the most important consideration when a court reviews an exemplary-damage award.[90] Instead, the degree of reprehensibility is "'[p]erhaps the most important indicium' of the reasonableness of a punitive damage award."[91] Because net worth is "only one among several factors a jury should consider," the benefits it can bring will be minimal compared to the burdens listed above.[92]

Tort reform has also limited the benefits net-worth discovery can provide. In recent years, the Texas legislature has limited both the availability of exemplary damages and the amount of the potential exemplary-damage award. In 1995, Texas heightened the standard of proof required for an exemplary-damage award to clear and convincing evidence.[93] Additionally, Texas codified the bifurcation requirement[94] announced in *Transportation Insurance Co. v. Moriel*.[95] Under this requirement, a trial court is required to bifurcate an exemplary-damage case upon a defendant's motion such that the first phase of the trial determines liability and the second phase determines the amount to be awarded.[96] In 2003, Texas further scaled back the potential for exemplary-damage awards.[97] As of 2003, Texas requires a unanimous verdict to support awarding exemplary damages.[98] Texas also has imposed a cap on some exemplary-damage awards.[99] These

90. *Id.* at 50 n.8. Judge Sullivan also notes that "a post-*Lunsford* jury may still decide on the amount of punitive damages without considering evidence of the defendant's net worth." *Id.* This is true if no evidence of net worth is presented, *see* Durban v. Guajardo, 79 S.W.3d 198, 210–11 (Tex. App.—Dallas 2002, no pet.) (holding that a plaintiff is not required to put on evidence of a defendant's net worth in order to recover exemplary damages), but when evidence is presented on net worth, the trier of fact must consider it under the plain language of the statute. *See supra* note 72 and accompanying text.

91. Owens-Corning Fiberglas Corp. v. Malone, 972 S.W.2d 35, 45–46 (Tex. 1998) (alteration in original) (quoting BMW of N. Am. Inc. v. Gore, 517 U.S. 559, 575 (1996)).

92. *Jacobs*, 300 S.W.3d at 50 n.8.

93. Act of Apr. 11, 1995, 74th Leg., R.S., ch. 19, § 1, 1995 Tex. Gen. Laws 108 (current version at TEX. CIV. PRAC. & REM. CODE § 41.003 (West 2010)).

94. *Id.* (current version at TEX. CIV. PRAC. & REM. CODE § 41.009 (West 2010)).

95. 879 S.W.2d 10 (Tex. 1994).

96. CIV. PRAC. & REM. § 41.009.

97. Act of June 2, 2003, 78th Leg., R.S., ch. 204, § 4.07, 2003 Tex. Gen. Laws 847, 886–89 (current version at TEX. CIV. PRAC. & REM. CODE § 33.013 (West 2010)).

98. CIV. PRAC. & REM. § 41.003(d).

99. *Id.* § 41.008(b); *see also* Emily Ramshaw, *State's Tort Reform Makes Lawyers Wary of Taking on Patients*, N.Y. TIMES (Dec. 18, 2010), http://www.nytimes.com/2010/12/19/us/19tttort.html ("The tort reform that state lawmakers passed in 2003 made it more difficult for patients to win damages in any health care setting, but especially emergency rooms. It capped medical liability for noneconomic damages at $250,000 per health care provider, with a maximum award of $750,000.").

limitations combined have decreased the scope of exemplary damages and, thereby, the utility of net-worth discovery such that net-worth discovery "may serve little practical purpose in many cases."[100] This decreased utility gives courts a reason to find that the burdens of net-worth discovery outweigh its benefits. More significantly, it gives courts a reason to impose a principled limitation on net-worth discovery.

B. Arguments Against Limiting Net-Worth Discovery

Subpart A presents the common arguments in favor of limiting net-worth discovery. The following subpart addresses the concerns raised by the potential burdens listed above and argues that the benefits are more than minimal.

1. Satellite Litigation.—The concerns about burdensome satellite litigation concerning discovery disputes[101] are undercut by some of the same arguments that state that the benefits of net-worth discovery are minimal. First, exemplary-damage cases are not common. This is partially a result of tort reform,[102] but empirically speaking, exemplary-damage cases simply do not come up often.[103] Thus, the concerns about satellite litigation are diminished by the fact that satellite litigation will not have many opportunities to occur.[104] Additionally, if satellite litigation is a concern, the solution should not disadvantage only the discovering party. Instead, the focus should be on ensuring that both parties adhere to the cooperative spirit embodied in the discovery rules.

2. Intrusiveness of Discovery.—The concerns about the intrusive nature of net-worth discovery will always be present. But the impact of the intrusiveness will likely only be felt by a few defendants. For example, "a case against a publicly traded corporation may present little problem . . . as its net worth should be discernible simply from the contents of a widely available annual report."[105] Thus, the concerns about intrusiveness will only be present

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100. *In re* Jacobs, 300 S.W.3d 35, 50 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (Sullivan, J., concurring).

101. *See supra* notes 79–84 and accompanying text.

102. *See Jacobs*, 300 S.W.3d at 50 (Sullivan, J., concurring) ("[T]hese revisions dramatically lessened the chances of *any* punitive-damage recovery by a claimant." (emphasis in original)).

103. *See* LYNN LANGTON & THOMAS H. COHEN, BUREAU OF JUSTICE STATISTICS, CIVIL BENCH AND JURY TRIALS IN STATE COURTS, 2005, at 6 (2008) (indicating that only 13% of civil trials in 2005 involved a punitive-damage claim and only 5% of civil trials resulted in an award of punitive damages).

104. This point is strengthened by the fact that satellite litigation will only arise in a subset of exemplary-damage cases. There will be cases in which the parties cooperate throughout the discovery process. Thus, satellite litigation will only arise in a subset of a small percentage of cases.

105. *Jacobs*, 300 S.W.3d at 51 (Sullivan, J., concurring).

for those defendants that do not have their financial information publicly accessible. For these defendants, the intrusiveness of this discovery is inescapable. But the intrusiveness of this discovery is nothing new. The same considerations were in place when *Lunsford* was decided[106] and when section 41.011 was codified. It is unclear why the intrusiveness of this discovery should carry more weight now, particularly in light of the protections that have already been afforded to defendants through tort reform.

Additionally, concerns about net-worth information prejudicing the jury do not warrant limitations. These concerns have been addressed through the bifurcation requirement announced in *Moriel* and later codified in 2003.[107] If a defendant is concerned about net-worth evidence prejudicing the jury, he can move to bifurcate, and the jury will only hear the evidence if the defendant's conduct is found to justify exemplary damages.

3. Policy Justifications for Exemplary Damages.—While the above sections dispute some of the concerns against net-worth discovery, this section examines the role net-worth discovery plays in furthering the policy behind exemplary damages. Exemplary damages are a unique remedy. Where general remedial goals focus on compensating an injured party, exemplary damages are concerned with punishing the defendant for wrongful conduct.[108] Net-worth discovery is one mechanism to ensure that a trier of fact can adequately achieve that policy goal. Some argue that net-worth information should be irrelevant to determining an amount of exemplary damages,[109] but "[i]f the jury is to figure out how large an award is necessary to punish . . . the defendant, it surely must know something of his wealth."[110]

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106. Then-Chief Justice Phillips addressed concerns about a defendant's privacy in his dissent. Lunsford v. Morris, 746 S.W.2d 471, 477 (Tex. 1988) (Phillips, C.J., dissenting), *disapproved on other grounds by* Walker v. Packer, 827 S.W.2d 833 (Tex. 1992). Chief Justice Phillips dissented because he did not agree that mandamus was the proper vehicle to overrule *Young v. Kuhn*. *Id.* He did not, however, agree with Justice Gonzalez that a bifurcation requirement was the best method to protect defendants. *Id.* Instead, Chief Justice Phillips argued that the trial court was in the best position to protect "the defendant's legitimate interests against prejudice and the invasion of privacy . . . by placing limits on the scope and nature of discovery, issuing protective orders, and giving such jury instructions as may be appropriate." *Id.* Thus, concerns about the intrusiveness of discovery did not prevent the *Lunsford* court from allowing net-worth discovery.

107. *See supra* notes 94–97 and accompanying text.

108. *See* TEX. CIV. PRAC. & REM. CODE § 41.001(5) (West 2010) ("'Exemplary damages' means any damages awarded as a penalty or by way of punishment but not for compensatory purposes."); Exxon Shipping Co. v. Baker, 554 U.S. 471, 492 (2008) ("[T]he consensus today is that punitives are aimed not at compensation but principally at retribution and deterring harmful conduct."); DOUGLAS LAYCOCK, MODERN AMERICAN REMEDIES: CASES AND MATERIALS 4 (4th ed. 2010) (explaining that punitive damages are the best known of punitive civil remedies and that they "are designed to punish wrongdoers").

109. *See* Kenneth S. Abraham & John C. Jeffries, Jr., *Punitive Damages and the Rule of Law: The Role of Defendant's Wealth*, 18 J. LEGAL STUD. 415, 415 (1989) (arguing that the defendant's wealth "is an improper consideration in assessing the basis for retribution").

110. LAYCOCK, *supra* note 108, at 231; *see also Lunsford*, 746 S.W.2d at 472–73 ("[O]ne hundred dollars as a punitive award against a single mother . . . may be a greater deterrent than one

Limiting the discoverable net-worth information hinders a jury's ability to adequately punish wrongful defendants.

The role of net worth in determining the amount necessary to punish the defendant highlights the importance of including net worth among the factors that a trier of fact must consider. Net-worth information provides a trier of fact with principled guidance in determining a proper punishment. An amount that is too low or too high will not achieve the policy goal of punishment. Thus, net worth may not be the most important factor in *reviewing* an exemplary-damage award,[111] but it is an important factor in determining *how much* is necessary to punish once punishment is determined to be warranted.

4. Tort Reform.—The final argument in favor of limiting net-worth discovery is based on the limitations tort reform placed on exemplary damages.[112] But despite these limitations, the broad language of the net-worth discovery provision remains. The legislature could have amended the net-worth provision if the legislature intended to limit the discoverable information. Instead, section 41.011 has not been amended and a trier of fact is still required to consider any evidence relating to net worth.[113] Additionally, the general limitations on exemplary damages do not necessarily equate to limitations on discovery. Instead, one could argue that because it is a rare case in which exemplary damages will be awarded, those defendants are more deserving of punishment. Thus, net-worth discovery would be even more important to ensuring that those defendants received adequate punishment.

V. Proposed Standard

The above discussion highlights the problems facing trial courts charged with determining what materials are relevant to a defendant's net worth. First, there are competing concerns regarding clarity. Simply stating that net worth is discoverable gives courts no guidance, but a bright-line rule, like the GAAP standard, is inconsistent with the statutory language. Second, there are competing policy concerns. Allowing discovery of net-worth information is inherently intrusive, but limiting the discoverable materials hinders a jury's ability to adequately punish the defendant's wrongdoing. The standard proposed below addresses these competing concerns.

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hundred thousand dollars awarded against a major corporation whose directors are shielded from the stark reality of harm done by the paneled walls and plush carpet of the corporate boardroom.").

111. *See supra* notes 90–91 and accompanying text.

112. *See supra* notes 93–100 and accompanying text.

113. *See supra* notes 69–72 and accompanying text.

A. Accurate Representation

In exemplary-damage cases, courts should allow the discovery necessary to give an *accurate representation* of the defendant's *current* net worth. This accurate-representation standard derives from the analysis utilized by some Texas appellate courts[114] and modifies the standards of others[115] in hopes of addressing all of the relevant concerns. It provides clarification with respect to the two prominent discovery concerns: (1) the relevant time period and (2) the relevant materials.

1. Timing.—Courts have recently begun limiting discovery to a defendant's current net worth.[116] Most recently, current has been defined to mean at the time of the discovery response.[117] It is unclear, however, from where this specific limitation arose because neither the Texas Supreme Court nor the statutory language provides for it.[118] Courts are correct in wanting to put some time limitation in place based on traditional discovery principles,[119] but a bright-line rule limiting discovery to only those materials relating to the

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114. "Accurate representation" comes from the analysis provided by the First District Court of Appeals in *In re Brewer Leasing, Inc.*, 255 S.W.3d 708, 712 (Tex. App.—Houston [1st Dist.] 2008, no pet.). In *Brewer Leasing*, Brewer relied upon *Sears, Roebuck & Co.* to argue that the trial court abused its discretion in requiring Brewer to produce more than balance sheets showing his net worth. *Id.* at 712–13. Specifically, Brewer argued that his situation was similar to the defendant's in *Sears* "because the balance sheets [Brewer had] produced [made] the discovery of other financial records unnecessarily duplicative." *Id.* at 713. The court distinguished Brewer's situation, however, because Brewer's balance sheets were "not audited, not certified, and [did] not include any affidavit or other statement to represent that they accurately reflect[ed] the net worth." *Id.* The court reasoned that the trial court's order to produce the documents was an implicit determination that the balance sheets were insufficient to show net worth. *Id.* Thus, had the balance sheets *accurately reflected* Brewer's net worth, the balance sheets would have been sufficient. The accurate-representation language is meant to facilitate such an analysis.

115. "Current" comes from the timing limitations already imposed by the courts in *Jacobs* and *House of Yahweh*. *See supra* notes 41–47 and accompanying text. This standard's use of current, however, is not as restrictive as those imposed by the *Jacobs* and *House of Yahweh* courts because the accurate-representation language allows for broader discovery if necessary. *See infra* section V(A)(1).

116. *See supra* notes 41–47 and accompanying text.

117. *See supra* note 46.

118. The first reference to limiting discovery to current net worth appears to have come in *House of Yahweh*, which has been cited for this proposition. *See In re* Ameriplan Corp., No. 05-09-01407-CV, 2010 WL 22825, at *1 (Tex. App.—Dallas Jan. 6, 2010, no pet.) (mem. op.); *In re* Jacobs, 300 S.W.3d 35, 44–45 (Tex. App.—Houston [14th Dist.] 2009, no pet.) (both citing *House of Yahweh* to support limiting discovery to current net worth). The court in *House of Yahweh*, however, provided no authority for this limitation. *In re* House of Yahweh, 266 S.W.3d 668, 673 (Tex. App.—Eastland 2008, no pet.). The court in *Jacobs* cited cases from other jurisdictions—Kansas, Illinois, and Oklahoma—as examples of courts holding that only current net worth is relevant to an exemplary-damage claim, but the court did not cite any other Texas authority. *Jacobs*, 300 S.W.3d at 45 n.10.

119. *See In re* Alford Chevrolet-Geo, 997 S.W.2d 173, 180 n.1 (Tex. 1999) ("We have identified as overbroad requests encompassing time periods . . . beyond those at issue in the case . . . ."); *Jacobs*, 300 S.W.3d at 44 (stating that "a trial court abuses its discretion when it compels overly broad discovery" and that "[o]verbroad requests encompass time periods or activities beyond those at issue in the case—in other words, matters of questionable relevance").

defendant's net worth at the time the defendant is responding to the request is too narrow. A defendant's net worth at the time of the events giving rise to the cause of action may be relevant for the simple fact that the defendant could make financial changes in anticipation of such discovery. Additionally, earlier time periods may be relevant to show how much a defendant profited from the wrongdoing that resulted in the lawsuit. The discovery standard needs to be flexible enough to address these types of events and allow a plaintiff to make out his case.

The proposed accurate-representation standard addresses both plaintiff and defendant concerns regarding timing. By incorporating the "current" language from recent decisions, the standard will allow defendants to avoid the discovery orders from the past that required the disclosure of five or ten years' worth of materials. On the other hand, the "accurate representation" language will provide plaintiffs the necessary flexibility to prepare their case. If a plaintiff or a court suspects that the information provided by the defendant does not accurately reflect the defendant's true net worth, more discovery can be requested or ordered. Thus, rather than follow an arbitrary time limit, the parties and courts will be focusing on the events in question to determine the points at which net worth could be relevant.

2. Materials.—Once the relevant time period is resolved, the question turns to what materials to allow. Some courts have limited discovery to only those materials that show both assets and liabilities, most commonly balance sheets.[120] Before this limitation, courts allowed discovery of a broad range of materials, including income tax returns.[121] Each of these standards, however, favors one side at the expense of the other. In some instances balance sheets could potentially be adequate to provide an accurate representation of a defendant's net worth. But balance sheets alone will not always suffice.[122] Additionally, courts have consistently held that income tax returns alone are insufficient for net-worth determinations. Rather than disadvantage one side, the proper discovery standard should attempt to balance the competing interests.

The accurate-representation standard addresses the inadequacies mentioned above. Because income tax returns alone are insufficient to provide an accurate representation of net worth, a defendant would not be required to disclose them. Additionally, in the cases in which balance sheets alone are inadequate for a net-worth determination, a plaintiff would be entitled to the additional information that is necessary to reach an accurate representation. Thus, the accurate-representation standard prevents plaintiffs

120. *See supra* section II(C)(2).
121. *See supra* subpart II(C).
122. *See supra* note 114.

from receiving anything and everything relating to net worth, but the standard also prevents defendants from disclosing only inadequate materials.

VI. Conclusion

This Note has highlighted some of the problems that have resulted from ambiguity in the law regarding net-worth discovery in exemplary-damage cases. As a result of the ambiguity, different courts have developed different standards regarding the proper scope of discovery. Some courts have severely limited discovery while others have gone just as far in the other direction. In an attempt to address these problems, this Note presented an analysis of the advantages and disadvantages of net-worth discovery. Finally, this Note proposed an accurate-representation standard that, if adopted, would address the concerns of parties on both sides of the net-worth debate. This standard, however, is not offered as the only solution to the net-worth problems. The Texas Supreme Court has a number of options at its disposal to provide clarity in this area of law. The important thing is simply that clarity is provided.

—Anthony F. Arguijo

Something Like the Sun: Why Even "Isolated and Purified" Genes Are Still Products of Nature*

"[T]he heat of the sun, electricity, or the qualities of metals, are part of the storehouse of knowledge of all men. They are manifestations of laws of nature, free to all men and reserved exclusively to none."[1]

—U.S. Supreme Court

And yet, by heaven, I think my love as rare
As any she belied with false compare.[2]

—William Shakespeare

I. Introduction

On March 29, 2010, Judge Sweet of the Southern District of New York issued an opinion in the case of *Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office*[3] holding that human genes are not patentable subject matter.[4] The ruling was a notable departure from thirty years of settled law.[5] The U.S. Patent and Trademark Office (USPTO) has routinely issued patents involving human genes[6] despite the broad-based opposition to such exclusive rights from religious, scientific, medical, and human rights groups.[7] Judge Sweet's ruling is certainly not the end of the story, but it is an indication that the accepted law is subject to persuasive criticism.

What would convince a district court judge to declare a whole class of subject matter unpatentable despite almost thirty years of case law and USPTO decisions? Part of the answer lies in the particulars of the case and the behavior of Myriad Genetics in enforcing and licensing its patents.

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* I would like to thank Professor John Golden for his help developing this topic and his extensive feedback and suggestions on earlier versions of this Note. I am indebted also to the editors and staff of Texas Law Review for their tremendous work and dedication in preparing this Note for publication. Finally I want to express my deep gratitude and love for my wife, Rachel, for all of her love, support, and encouragement without which I could not survive, let alone write.

1. Funk Bros. Seed Co. v. Kalo Inoculant Co., 333 U.S. 127, 130 (1948).

2. WILLIAM SHAKESPEARE, SONNET NO. 130.

3. 702 F. Supp. 2d 181 (S.D.N.Y. 2010).

4. *Id.* at 232, 237.

5. In 1982, the U.S. Patent and Trademark Office issued the first patent specifically covering a human gene. U.S. Patent No. 4,322,499 (filed Dec. 22, 1978). The patent covered a gene fragment relating to a human pituitary hormone and granted the inventors, scientists at the University of California, the right to exclude others from making, using, selling, or importing the invention. *Id.* at [57]; *see also* 35 U.S.C. § 154(a)(1) (2006) (enumerating the contents and terms of a patent in the United States).

6. *See* Timothy Caulfield, *Human Gene Patents: Proof of Problems?*, 84 CHI.-KENT L. REV. 133, 133 (2009) (noting that the patenting of genes has been "common practice" for thirty years).

7. *See Ass'n for Molecular Pathology*, 702 F. Supp. 2d at 190–92 (listing the amici curiae for the plaintiff and summarizing their arguments).

Myriad is alleged to have engaged in aggressive enforcement against academic researchers and also to have repeatedly refused to license its rights to potential competitors, both of which are uncommon behaviors in the biotechnology industry and have a whiff of anticompetitiveness.[8] Judge Sweet grounded his ruling in the language of consequential arguments—that gene patents of the type at issue are harmful to patients[9] and downstream research.[10] But the decision remains agnostic about these concerns[11] and instead focuses on the statutory subject-matter requirement.[12] Judge Sweet had before him, not a parade of hypothetical economic and medical horribles, but a living, breathing horrible—albeit constituting a parade of only one patent holder. Perhaps this is a case where bad facts make (for the moment) good law, but this Note argues that the doctrinal hook on which Judge Sweet fixed his ruling—the "product of nature" doctrine—is, and should be, more directly connected to the underlying policy concerns than Judge Sweet's agnosticism indicates.

In 1980, the U.S. Supreme Court decided its first, and to this date only, decision directly addressing the question of patentability of living organisms in *Diamond v. Chakrabarty*.[13] In upholding the patent for a laboratory-created bacterium with properties not found in nature, the Court quoted with approval from the legislative record of the Patent Act of 1952[14] in which both houses of Congress advanced the sweeping conception of patentable subject matter as including anything "under the sun that is made by man."[15] Although the Court went on to clarify this assertion by reaffirming the longstanding "product of nature" prohibition on patents for "laws of nature, physical phenomena, and abstract ideas,"[16] *Chakrabarty* signaled the end to any blanket prohibition on patents on living organisms or, as it turns out, their building blocks and opened the door for the biotechnology revolution.[17] Shortly thereafter, in 1982, the USPTO issued the first patent covering human genetic material.[18] Since that time, the USPTO has issued thousands

8. *See infra* subpart V(A).

9. *Ass'n for Molecular Pathology*, 702 F. Supp. 2d at 206–07.

10. *Id.* at 207–11.

11. *See id.* at 211 ("[T]here exists a sharp dispute concerning the impact of patents directed to isolated DNA on genetic research and consequently the health of society. . . . [T]he resolution of these disputes of fact and policy are not possible [at this time].").

12. *Id.* at 218–20.

13. 447 U.S. 303 (1980).

14. Pub. L. No. 82-593, 66 Stat. 792.

15. S. REP. NO. 82-1979, at 5 (1952); H.R. REP. NO. 82-1923, at 6 (1952).

16. *Chakrabarty*, 447 U.S. at 309.

17. Prior to *Chakrabarty*, a presumption existed that living organisms were unpatentable—a presumption invoked by the patent examiner as an alternative reason for denying the original claim. *Id.* at 306. One of the defense arguments in *Chakrabarty* for invalidity was the fact that Congress had separately enacted the Plant Patent Act implying that patents on living organisms required separate, specific authorization. *Id.*

18. *See supra* notes 5–6.

of patents involving genes, and it was estimated in a 2005 study that 20% of the human genome was already subject to issued patents.[19] Genetic material is patentable, despite being a naturally occurring substance, by virtue of the well-established "isolation and purification" doctrine.[20] Under this doctrine, genes are patentable when separated from their naturally occurring environment (e.g., chromosomes of living organisms).[21] While this distinction has a chemical meaning, it has only questionable substantive meaning.[22] Nevertheless, the uncontroversial legal status of genetic material as patentable subject matter has led at least two commentators to declare the product of nature doctrine effectively a dead letter in biotechnology.[23]

A substantial body of academic work criticizes the isolation and purification doctrine and the very notion that genetic material should be the legitimate subject of intellectual property rights.[24] Congress has considered legislation with the intent of removing genetic material from the category of

19. Kyle Jensen & Fiona Murray, *Intellectual Property Landscape of the Human Genome*, 310 SCI. 239, 239 (2005).

20. *See* USPTO Utility Examination Guidelines, 66 Fed. Reg. 1092, 1093 (Jan. 5, 2001) (affirming the patentability of purified or isolated genes and noting that "[p]atenting compositions or compounds isolated from nature follows well-established principles, and is not a new practice").

21. *Id.*

22. In other words, it is not readily apparent why an otherwise naturally occurring chemical should be the subject of a private property right simply by virtue of having been isolated from nature.

23. *See* John M. Conley & Roberte Makowski, *Back to the Future: Rethinking the Product of Nature Doctrine as a Barrier to Biotechnology Patents (Part II)*, 85 J. PAT. & TRADEMARK OFF. SOC'Y 371, 388 (2003) (explaining that regulators do not scrutinize patent applications under the product of nature doctrine but, rather, draw incoherent conclusions based on terms such as *isolated* and *purified* that appear in applications).

24. *See, e.g.*, MATTHEW ALBRIGHT, PROFITS PENDING: HOW LIFE PATENTS REPRESENT THE BIGGEST SWINDLE OF THE 21ST CENTURY 139–43 (2004) (attacking a wide range of patents on living things); DAVID KOEPSELL, WHO OWNS YOU? THE CORPORATE GOLD RUSH TO PATENT YOUR GENES 111–14 (2009) (criticizing the claim that genetic research warrants intellectual property protections); DAVID B. RESNIK, OWNING THE GENOME: A MORAL ANALYSIS OF DNA PATENTING 73–83 (2004) (surveying the various arguments against patents on nature, including genes); Conley & Makowski, *supra* note 23, at 392 (criticizing the "talismanic status" of the isolation and purification doctrine); Mark J. Hanson, *Patenting Genes and Life: Improper Commodification?* (considering the effects of treating components of human life as commodities), *in* WHO OWNS LIFE? 161, 167–73 (David Magnus et al. eds., 2002). *But see* CLAUDE BARFIELD & JOHN E. CALFEE, BIOTECHNOLOGY AND THE PATENT SYSTEM: BALANCING INNOVATION AND PROPERTY RIGHTS 29–30 (2007) (summarizing theories that posit the necessity of strong intellectual property protection for biotechnology); Gerald Dworkin, *Should There Be Property Rights in Genes?*, 352 PHIL. TRANSACTIONS: BIOLOGICAL SCI. 1077, 1085–86 (1997) (reflecting a skeptical eye toward treating gene patents differently from other intellectual property); Melissa Wetkowski, *Unfitting: Gene Patent Limitations Too Tight for United States' Biotechnology Innovation and Growth in Light of International Patenting Policies*, 16 SW. J. INT'L LAW 181, 196–99 (2010) (considering the detrimental effects of decreasing intellectual property protection for genes in the United States).

patentable subject matter.[25] The issue continues to be the subject of litigation as well, although to this date the law remains unchanged. The critics of gene patents have won a battle in the *Ass'n for Molecular Pathology* decision; whether it will lead to a victory in the war depends on whether the Federal Circuit and, ultimately, the Supreme Court are willing to take another look at both the product of nature and isolation and purification doctrines.[26]

This Note argues that, properly understood, the doctrines require the exclusion of gene patents encompassing functional genetic information. Part II introduces the basic science of genes and argues that genes are best conceived of as carriers of information with unique properties significant to the question of patentability. Part III explains the product of nature and isolation and purification doctrines, which permit the patenting of genes, and attempts to explain the rationale behind those doctrines. Parts IV and V break down the economic and moral arguments against gene patents and tie them to both the characteristics of genetic information identified in Part II and the doctrines described in Part III. Finally, in Part VI, I briefly discuss the prospects for exclusion of genetic information from patentable subject matter and take up some objections.

II. The Science of Gene Patents

Before discussing the legal doctrines and their application, it will be helpful to clearly define what is meant by a gene patent. This is easier said than done. Gene patents cover a wide variety of claims, including chemical sequences,[27] methods for detecting and comparing sequences,[28] processes for creating and combining sequences,[29] and even claims covering living organisms defined, in part, by their genetic makeup.[30] Furthermore, despite its apparent centrality to modern biotechnology, the definition of a "gene"

25. *See, e.g.*, Genomic Research and Accessibility Act, H.R. 977, 110th Cong. (2007) (proposing to prohibit patents "for a nucleotide sequence, or its functions or correlations, or the naturally occurring products it specifies").

26. *Ass'n for Molecular Pathology* is currently on appeal to the Court of Appeals for the Federal Circuit. Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 702 F. Supp. 2d 181 (S.D.N.Y. 2010), *appeal docketed*, No. 2010-1406 (Fed. Cir. June 22, 2010).

27. *See, e.g.*, U.S. Patent No. 4,703,008 col.39 *l.*61–col.40 *l.*3 (filed Nov. 30, 1984) (noting Amgen's claim to have developed a purified and isolated DNA sequence to encode human erythropoietin).

28. *See, e.g.*, U.S. Patent No. 5,710,001 col.155 *ll.*1–17 (filed June 7, 1995) (explaining a new method for screening a tumor sample for alteration in a BRCA1 gene).

29. *See, e.g.*, U.S. Patent No. 4,631,259 col.10 *ll.*12–62 (filed May 4, 1983) (summarizing claims for a gene-cloning process that involves the transformation of Tn 916 bacteria and the excision of such bacteria from a DNA structure).

30. *See, e.g.*, U.S. Patent No. 4,736,866 col.9 *l.*34–col.10 *l.*2 (filed June 22, 1984) (describing a claim to insert genetic sequences of mammalian ancestors into a transgenic mammal at an embryonic stage).

outside of the patent context is neither clear nor consistent.[31] As our understanding of heredity, cellular biology, and the path connecting genetic sequences to the traits of living organisms grows, it has become increasingly clear that the conventional understanding of a gene as a single, contiguous sequence of chemical base pairs responsible for the production of a single protein is simply wrong.[32] This backdrop of uncertainty about the true nature of genetic material provides the foundation for at least one argument against the patenting of genes—we are not even sure of the scope of the right being granted because we only barely understand the related biology.[33] Nevertheless, it is important to make some attempt at a definition. It is my contention that genes are best understood not as chemical compounds but as carriers of information—complex and detailed information—and that this unique nature of genes provides the link between the moral objections to gene patents and the doctrinal basis for their exclusion.

A. Genes as Information

In 1953, Watson and Crick identified the now famous ladder-like twisted-helix structure of deoxyribonucleic acid (DNA).[34] The discovery revealed the basic chemical structure of genetic material for all life on earth and ushered in the modern era of genetics.[35] Classical genetics had provided the basis for complex theories of inheritance and evolution, but the chemical mechanism by which individual traits are stored, expressed, and reproduced was unknown.[36] DNA is responsible, through a complex process, for the production of proteins—which direct and influence the activities of cells and, thus, the functions of living things.[37] Human DNA contains the information that ultimately produces eye color, makes nerve cells transmit sensations, and puts fingers on our hands.

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31. *See* Andrew W. Torrance, *Gene Concepts, Gene Talk, and Gene Patents*, 11 MINN. J.L. SCI. & TECH. 157, 160–61 (2010) ("[D]ebates about what a 'gene' really is have raged within the biology community.").

32. *Id.* at 170–74. In his 2007 survey of biotechnology law, Robert A. Bohrer felt compelled to add a parenthetical caveat to his section on the basic science of genetics: "From DNA to RNA to Protein: The Central Dogma of Molecular Biology (Now Known to be False!)." ROBERT A. BOHRER, A GUIDE TO BIOTECHNOLOGY LAW AND BUSINESS 20–21 (2007).

33. *See* Eileen M. Kane, *Splitting the Gene: DNA Patents and the Genetic Code*, 71 TENN. L. REV. 707, 722–23 (2004) (highlighting the disparity between the increasingly complex understanding of microbiology and patent law treatment of genes).

34. *See generally* James D. Watson & Francis H. C. Crick, *A Structure for Deoxyribose Nucleic Acid*, 171 NATURE 737 (1953) (unveiling the twisted-helix DNA structure that they discovered).

35. *See* RESNIK, *supra* note 24, at 14 (characterizing Watson & Crick's discovery as illuminating the mechanics of genetic encoding and transmission).

36. *See id.* at 13–14 (tracing classical genetics from Gregor Mendel through the discovery of DNA).

37. *See id.* at 18–22 (describing the mechanism of "gene expression").

DNA is a chemical composed of two long parallel strands of sugar (deoxyribose) and phosphate molecules (the sides of the ladder) connected by pairs of interlocking nucleotides that form the rungs.[38] There are four different types of nucleotides: adenine (A), guanine (G), thymidine (T), and cytosine (C).[39] Each of the rungs (called a base pair) in a strand of DNA is a pair of two of these nucleotides, one extending from each side of the ladder.[40] In addition, the rung pairings are limited: A is always paired with T and G always with C.[41] If the sequence on one side of a DNA ladder is AAGT, the corresponding sequence to which it connects will be TTCA. A single strand of DNA (half of the ladder split vertically down the middle) can be conceived of as a sequence of nucleotides represented by a long string of letters from the four possibilities, AGTC. One strand of DNA contains all of the information necessary to correctly describe the complementary half.[42] Furthermore, because the chemical interlocking between pairs of nucleotides is predictable, the information (sequence) contained in a single strand of DNA is replicated and preserved in its complementary strand. This is the first important fact supporting the conception of DNA as a carrier of information rather than as a simple chemical compound. The second is the connection between these ordered base pairs and the creation of proteins.[43]

The sequence of letters in a strand of human DNA is not arbitrary. Encoded within that sequence are instructions for the creation of proteins—chemical compounds made up of amino acids.[44] Certain three-letter sequences of DNA, called codons, encode for an amino acid.[45] Codons that work together to provide the information necessary for protein synthesis are called exons.[46] These proteins then act alone or in complex combination

38. BOHRER, *supra* note 32, at 19–20; *see also The Science Behind the Human Genome Project*, HUM. GENOME PROJECT INFO., http://www.ornl.gov/sci/techresources/Human_Genome/project/info.shtml.

39. BOHRER, *supra* note 32, at 20.

40. *Id.*

41. *Id.*

42. *Id.*

43. It may be important to point out at this time that the informational nature of DNA is distinct from the informational nature of any other chemical compound. This is a notion I will return to later, but it is worth highlighting that, while any chemical compound inherently contains information about itself (e.g., its structure and composition), DNA contains information of a programmatic nature. *See id.* at 21 (emphasizing that each DNA segment contains the instructions for creating a specific protein).

44. *Id.*

45. *Id.* at 20.

46. Exons are only a small portion of the human genome, which is made up mostly of noncoding introns. ANTHONY J. F. GRIFFITHS ET AL., MODERN GENETIC ANALYSIS: INTEGRATING GENES AND GENOMES 302 (2d ed. 2002). Furthermore, the exons of a gene are often not contiguous but rather interspersed with long noncoding sequences. BOHRER, *supra* note 32, at 21. This becomes important in understanding what is actually patentable under the isolation and purification exception. *See infra* subpart III(B).

with other proteins to perform various cellular functions.[47] These proteins are created by a chemical process in which a DNA strand splits in half, exposing the base-pair sequences.[48] Then, through a complex interaction with another kind of genetic material, RNA, the information contained in the exposed DNA is replicated, translated, and used ultimately to assemble proteins.[49] The details of the transmission of genetic code and assembly of proteins within cells are very complex and beyond the scope of this Note. The important point is that DNA and the various kinds of RNA contain functional genetic information—information that is stored in the form of nucleotide pairs and that is involved in an identifiable cellular process such as protein production.[50] Functional genetic information has three characteristics important to my later analysis under the product of nature doctrine:[51] (1) genetic information is essential: it concerns the creation and operation of all known living organisms;[52] (2) genetic information is expression independent: the chemical compositions of DNA and RNA are storage media for this information, which can be copied and transmitted *without changing the information* and can also be represented in the abstract; and (3) genetic information is self-referential: genetic material contains within its structure the information about how to replicate, regulate, and communicate that information—i.e., the chemical contains within its structure information about the function and utility of that structure. In some ways, the second and third characteristics are paradoxical. Expression independence suggests that the chemical compound is separate from the information while self-reference suggests that the chemical compound is an essential aspect of the

47. JULIA E. RICHARDS & R. SCOTT HAWLEY, THE HUMAN GENOME: A USER'S GUIDE 135 (3d ed. 2011).

48. GEORGE WEI, AN INTRODUCTION TO GENETIC ENGINEERING, LIFE SCIENCES AND THE LAW 10 (2002).

49. RNA stands for "ribonucleic acid" and has essentially the same chemical composition as DNA except that it is a single strand and the nucleotide uracil (designated by "U") substitutes for thymine. RESNIK, *supra* note 24, at 18. There are several different types of RNA involved in the process of creating proteins, and each type is responsible for a different step in copying, transmitting, and executing the information contained in a particular DNA sequence. *See* WEI, *supra* note 48, at 10–11 (distinguishing the functions of RNA polymerase, mRNA, tRNA, and rRNA in the protein synthesis process). This Note does not address the question of whether RNA should be treated differently from DNA in the patent context.

50. As alluded to earlier, functional genetic information is implicated in more than just protein production. Genetic material is now understood to perform other functions such as regulation of gene expression. Torrance, *supra* note 31, at 169. Furthermore, the same nucleotide sequence may actually serve multiple functions in combination with different "genes." *Id.* at 172–73. The details of the current understanding of genes are beyond the scope of this Note, but the complexity does add weight to the concerns about gene patents by suggesting that we may be granting exclusive rights without really understanding the scope of those rights.

51. *See infra* Parts IV–V.

52. Although not all known living things contain DNA—some viruses, for example, employ only RNA in their biology—they do all contain chemical carriers of functional genetic information. BOHRER, *supra* note 32, at 24.

information. This tension can be resolved by understanding that expression independence reflects the scope of the information—genetic information implicates much more than just the chemical composition of DNA—while self-reference reflects the significance of the chemical compound in understanding genetic information—the former is required to use and understand the latter. These three characteristics of functional genetic information—essentialness, expression independence, and self-reference—provide a framework to understand both the moral objections to patenting genes and how those moral objections relate to the doctrinal argument for exclusion.[53]

A gene, then, for the purposes of this Note, is best conceived of as some discrete information—expressed in a chemical compound consisting of a sequence of nucleotide pairs—that is functionally significant in one or more identifiable cellular processes. Whether a gene codes for a single protein or a series of proteins or serves some other regulatory or programmatic function is not important. Because genes are carriers of essential, expression-independent, self-referential information, genes should be excluded from patentable subject matter under the product of nature doctrine. But before moving on to the relevant patent doctrines, it is important to clarify the specific type of gene-patent claim that is most relevant.

B. Functional Genetic Information Patents

The statutory categories of patentable subject matter are any "process, machine, manufacture, or composition of matter."[54] As highlighted earlier, the term *gene patent* can cover a wide array of claims.[55] Gene claims generally fall into either process or composition claims.[56] This Note is concerned with the latter.

Process claims, though they may entail the production or use of a particular gene, do not grant an exclusive right to the chemical compound beyond its use in the claimed process.[57] A method for creating a particular

53. While this particular list of characteristics is, as far as I know, my own, the conception of genes as informational rather than chemical is well established. *See* Rebecca S. Eisenberg, *Re-examining the Role of Patents in Appropriating the Value of DNA Sequences*, 49 EMORY L.J. 783, 786–87 (2000) (asking whether the dual nature of DNA sequences as molecules and information has implications for patentability); Torrance, *supra* note 31, at 168–70 (describing genes as carriers of static and programmatic information); *cf.* Seth Shulman, *Upstream Without a Paddle: Gene Patenting and the Protection of the "Infostructure,"* 84 CHI.-KENT L. REV. 91, 95–96 (2009) (analogizing the subject matter of gene patents to disfavored software patents encompassing "actionable knowledge," not physical inventions).

54. 35 U.S.C. § 101 (2006).

55. *See supra* notes 27–30 and accompanying text.

56. *See* Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 702 F. Supp. 2d 181, 212 (S.D.N.Y. 2010) (dividing Myriad's claims into these two categories).

57. *See* Corning v. Burden, 56 U.S. (15 How.) 252, 268 (1853) ("It is for the discovery or invention of some practicable method or means of producing a beneficial result or effect, that a [process] patent is granted, and not for the result or effect itself.").

strand of DNA or RNA is one example of a process claim.[58] Although the end product is a chemical, what is patented is the method of creating or isolating that chemical, not the physical chemical itself. Creation of an identical strand by an alternative process would not infringe on the process claim. A genetic test, the process by which the presence of a gene is detected, is another type of process claim.[59] Genetic tests often involve the use of a specific DNA strand (for example, a short but unique segment of complementary DNA is introduced into the testing medium to see whether it binds with the subject sample, thereby identifying the existence of the gene being tested).[60] Again, the process patent would entail the *use* of the genetic material, but the exclusive right is granted in the specific process, not the chemical compound itself. Process patents are generally disfavored by biotechnology companies as inadequate protection for many reasons, the primary being that they are susceptible to workarounds by competitors—the competitor simply identifies a slightly different process to obtain the result than the process described in the patent and avoids infringement.[61] Of much greater interest to biotechnology companies, then, is patent protection in the product itself, i.e., the physical gene.

Composition-of-matter claims encompassing genetic sequences can themselves come in a number of different forms. The most straightforward claim is a complete description of the nucleotide sequences composing the gene, but gene claims are also commonly made indirectly by claiming the entire nucleotide sequence identified by a complementary fragment.[62] In other words, the claim describes a sequence that is unique enough to bind only to a particular gene and what is claimed is essentially whatever that sequence binds to.[63] Some composition claims are written even more broadly by reference to the cellular function for which the gene codes (e.g., the

58. *See, e.g.*, U.S. Patent No. 4,631,259, *supra* note 29, at [57] (claiming two methods of producing DNA by cloning a gene).

59. *See, e.g.*, U.S. Patent No. 5,710,001, *supra* note 28, at [57] (claiming methods of detecting specific genetic alterations in a human tumor sample).

60. *See, e.g.*, *id.* col.28 *l.*66–col.29 *l.*34 (describing a test relying on the binding of DNA sequences complementary to a targeted portion of the human chromosome 17q).

61. *See* Nita Ghei, *Institutional Arrangements, Property Rights, and the Endogenity of Comparative Advantage*, 18 TRANSNAT'L L. & CONTEMP. PROBS. 617, 640 (2009) (contrasting the importance of product patents for U.S. pharmaceutical firms as compared to Europe). *But see* MARTIN KENNEY, BIOTECHNOLOGY: THE UNIVERSITY–INDUSTRIAL COMPLEX 257–60 (1986) (discussing the value of the 1984 Cohen–Buyer patent on a process for isolating DNA that is widely licensed and used throughout the biotechnology industry).

62. *See* John M. Conley, *Gene Patents and the Product of Nature Doctrine*, 84 CHI.-KENT L. REV. 109, 117–19 (2009) (discussing the techniques employed by patent writers to craft broad gene claims).

63. Because of the utility requirement, the inventor must know more about the gene than just its existence. However, one can see how this kind of claim, if granted, may capture more territory than is disclosed in the patent. *See* USPTO Utility Examination Guidelines, 66 Fed. Reg. 1092, 1092–97 (Jan. 5, 2001) (discussing the utility requirement in the context of public comments concerning gene patents).

proteins produced or some other uniquely identifiable downstream effect). In other words, the claim is for the gene that produces this effect.[64] All of these composition claims are the same from the perspective of this Note because each one encompasses functional genetic information of the type described in subpart II(A).

As used in this Note, a gene patent is a composition-of-matter claim encompassing functional genetic information. The next Part describes current patent law and doctrines to explain how this particular type of claim is considered patentable subject matter.

III. Current Patent Law

In the United States, the patent system grants inventors and their assignees the right to exclude others from making, using, or selling the patented invention for a limited period.[65] In exchange for this right to exclude others, the patentee is required to disclose the details of the invention, and, after the patent duration (currently twenty years from the date of filing), the invention is essentially dedicated to the public.[66] This tradeoff between the monopoly right on one side and its limited term coupled with disclosure on the other is meant to balance the interests in spurring innovation against the social and economic costs of monopoly.[67] The power to grant monopoly rights in intellectual property is expressly found in the Constitution, which authorizes Congress "[t]o promote the Progress of Science and useful Arts, by securing for limited Times to Authors and Inventors the exclusive Right to their respective Writings and Discoveries."[68] The power is therefore directly tied to the economic incentive monopoly rights are assumed to provide. Furthermore, it is presumed that the intellectual property framework as implemented by statute embodies the tradeoff by, among other things, establishing requirements to ensure that the monopoly is granted only in cases where the incentive is needed and properly outweighs the costs.[69]

Among the statutory requirements for obtaining a patent is that the subject matter of the invention or discovery is a "new and useful process, machine, manufacture, or composition of matter, or any new and useful

64. Conley, *supra* note 62, at 119. Again, other doctrines of patent law exist to ensure that the inventor is actually in possession of the invention, so it is not enough to speculate that *some* gene is probably responsible for a cellular function and claim it. *See generally* 35 U.S.C. § 112 (2006) (setting out the requirements of specification).

65. 35 U.S.C. § 154(a)(1)–(2). Note that the patent is a negative right in the sense that the patent grants no affirmative right to the inventor to engage in these activities, just the right to exclude others. For example, the inventor of a new pharmaceutical cannot enter the market on a patent alone and must still meet FDA approval and any other requirements. *See generally* BOHRER, *supra* note 32, 197–255 (detailing regulatory issues in bringing biotechnology to market).

66. 35 U.S.C. §§ 112, 154(a)(2).

67. Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 146–47 (1989).

68. U.S. CONST. art. I, § 8, cl. 8.

69. *See, e.g.*, *Bonito Boats*, 489 U.S. at 148–49 (explaining why information already available to the public does not qualify for patent protection).

improvement thereof."[70] As discussed above, gene patents encompassing functional genetic information claims fall under composition of matter.[71] Claims of this kind describe, directly or indirectly, specific chemical compounds.[72] Chemical compounds are uncontroversial as patentable subject matter.[73] But the discussion does not stop there. The Supreme Court has made clear that there are limits on statutory subject matter despite the statutory language[74] and one of those limits—the product of nature doctrine—raises the question of patentability for functional genetic information. Under current law, however, the contours of this doctrine and the related doctrine for purified or isolated substances mean that functional genetic information is clearly patentable subject matter.[75]

A. The Product of Nature Doctrine

In 1980, the Supreme Court issued a critical decision in the field of biotechnology patents, *Diamond v. Chakrabarty*. By a 5–4 decision, the Court made clear that man-made living organisms were patentable subject matter under § 101.[76] The Court found that Congress had intended the 1952 Patent Act to include as patentable subject matter "'anything under the sun that is made by man.'"[77] This definitively ended the (already much weakened) presumption that living things were unpatentable.[78] To the extent that some subject matter was still excluded by the doctrine, the relevant distinction for the Court was not between living and inanimate things but between natural phenomena and man-made inventions.[79]

Ananda Chakrabarty, a microbiologist working for General Electric, filed a patent in 1972 for a "genetically engineered bacterium . . . capable of breaking down multiple components of crude oil."[80] Chakrabarty's patent was initially rejected by the patent examiner on the grounds that it claimed

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70. 35 U.S.C. § 101 (2006).

71. *See supra* subpart II(B).

72. *See supra* notes 62–64 and accompanying text.

73. *See* USPTO Utility Examination Guidelines, 66 Fed. Reg. 1092, 1095 (Jan. 5, 2001) ("Patent law provides no basis for treating DNA differently from other chemical compounds that are compositions of matter.").

74. *See* Diamond v. Chakrabarty, 447 U.S. 303, 309–10 (1980) (holding that Chakrabarty's claim to a "nonnaturally occurring . . . composition of matter" was not excluded as a product of nature).

75. USPTO Utility Examination Guidelines, 66 Fed. Reg. at 1093.

76. *Chakrabarty*, 447 U.S. at 318.

77. *Id.* at 309 (quoting S. REP. NO. 82-1979, at 5 (1952) and H.R. REP. NO. 82-1923, at 6 (1952)).

78. This presumption appears in more than one case and was actually the basis for the original denial of the patent by the USPTO. *Id.* at 306.

79. *See* J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc., 534 U.S. 124, 130 (2001) (quoting *Chakrabarty* in reaffirming this conception of the product of nature doctrine).

80. *Chakrabarty*, 447 U.S. at 305.

(1) a product of nature and (2) an inherently unpatentable living organism.[81] Each ground was overturned at various appeals stages, and the Supreme Court ultimately granted certiorari on the sole question of "whether a live, human-made micro-organism is patentable subject matter."[82] The divided court approached the question as a matter of statutory construction rather than constitutionality (i.e., whether Congress *had* authorized patents on living organisms, not whether it could), but nevertheless addressed the product of nature doctrine and declared Chakrabarty's bacterium to be a claim "not to a hitherto unknown natural phenomenon, but to a nonnaturally occurring manufacture or composition of matter—a product of human ingenuity" and therefore "not nature's handiwork, but his own."[83] The Court emphasized that Chakrabarty had "produced a new bacterium with markedly different characteristics from any found in nature."[84] In so ruling, however, the Court affirmed the product of nature doctrine as a limit on patentable subject matter, giving examples of three categories of unpatentable subject matter: "laws of nature, physical phenomena, and abstract ideas."[85] By way of examples, a new mineral or plant discovered in nature, Einstein's mass/energy equation, and the law of gravity were all said by the Court to be unpatentable.[86] The Court did not discuss the rationale behind the prohibition, except to quote an earlier case, *Funk Brothers Seed Co. v. Kalo Inoculant Co.*,[87] which excluded some subject matter as "manifestations of . . . nature, free to all men and reserved exclusively to none."[88]

In *Funk*, the Court considered the validity of a patent covering a mixture of naturally occurring bacteria for use as an inoculant for leguminous plants.[89] The inventor, Bond, had discovered a means of creating a generally applicable mixture, whereas previously in the art such inoculants were necessarily targeted for specific plants because of the incompatibilities among the various bacteria.[90] In finding the subject matter unpatentable, the Court reasoned that Bond had merely taken advantage of the naturally occurring properties of bacteria and that while identifying and combining compatible strains was commercially useful, his contribution did not rise to the level of invention.[91] As in *Chakrabarty*, the Court used examples to shed some light on the doctrine, comparing the qualities of the bacteria to "the heat of the

81. *In re* Chakrabarty, 571 F.2d 40, 42 (C.C.P.A. 1978).

82. *Chakrabarty*, 447 U.S. at 305. For a more detailed discussion of the procedural history, see Conley & Makowski, *supra* note 23, at 373–75.

83. *Chakrabarty*, 447 U.S. at 309–10.

84. *Id.* at 310.

85. *Id.* at 309.

86. *Id.*

87. 333 U.S. 127 (1948).

88. *Chakrabarty*, 447 U.S. at 309 (quoting *Funk*, 333 U.S. at 130).

89. *Funk*, 333 U.S. at 128–30.

90. *Id.*

91. *Id.* at 130–31.

sun, electricity, or the qualities of metals . . . which [are] part of the storehouse of knowledge of all men."[92]

The difference between the inventive contributions in *Funk* and *Chakrabarty* is not entirely clear aside from the biological level of combination. Dr. Chakrabarty took naturally occurring DNA and combined it inside a single bacterium strain while Bond combined several strains of bacteria into a specific mixture. It is therefore unclear whether the specific holding in *Funk* is still good law. However, the general principle that the product of nature doctrine excludes some subject matter from patentability clearly survives *Chakrabarty*.[93] The Supreme Court most recently reiterated its conception of the doctrine in 2001, quoting *Chakrabarty* in *J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred International, Inc.*[94]

Still, while the case law is consistent in affirming the existence of the doctrine, the contours of the doctrine itself are not particularly clear. In addition to the composition-of-matter claims discussed above, the doctrine has also been invoked in process claims.[95] Like the composition-of-matter cases, the process-claim cases have provided only a little insight into the reasoning behind the doctrine. *Gottschalk v. Benson*,[96] decided in 1972, addressed the question of whether a mathematical formula is patentable subject matter.[97] Writing for the Court, Justice Douglas quoted the general prohibition from *Funk* on the assumption that the same concerns (whatever those might be) apply to process patents.[98] The patent at issue in *Gottschalk* claimed an algorithm for converting decimal numbers to binary form.[99] In the opinion, Justice Douglas gave two explanations for the holding that such an algorithm was not patentable. He began with the principle that abstract ideas are not patentable because "they are the basic tools of scientific and technological work" and then noted that the claim in the case was "so abstract and

92. *Id.* at 130.

93. *See* Conley & Makowski, *supra* note 23, at 376 (suggesting that the product of nature doctrine has force even if the two cases are not reconcilable).

94. 534 U.S. 124, 134 (2001). More recently, Justice Breyer invoked the doctrine in a dissent from a dismissal of certiorari. Lab. Corp. of Am. Holdings v. Metabolite Labs., Inc., 548 U.S. 124, 126 (2006) (Breyer, J., dissenting).

95. *See, e.g.*, Diamond v. Diehr, 450 U.S. 175, 185 (1981) ("Our conclusion regarding respondents' claims is not altered by the fact that in several steps of the process a mathematical equation and a programmed digital computer are used. . . . Excluded from such patent protection are laws of nature, natural phenomena, and abstract ideas."); Parker v. Flook, 437 U.S. 584, 593 (1978) ("The rule that the discovery of a law of nature cannot be patented rests, not on the notion that natural phenomena are not processes, but rather on the more fundamental understanding that they are not the kind of 'discoveries' that the statute was enacted to protect.").

96. 409 U.S. 63 (1972).

97. *See id.* at 64–65 (stating that the respondent sought to patent an algorithm used for "programming a general-purpose digital computer to convert signals from binary-coded decimal form into pure binary form").

98. *Id.* at 67–68; *see also supra* notes 87–92 and accompanying text.

99. *Gottschalk*, 409 U.S. at 65.

sweeping as to cover both known and unknown uses."[100] In *Parker v. Flook*,[101] a 1978 case involving a process patent for updating the critical-alarm threshold of a class of monitored hydrocarbon catalyses by applying a preset calculation to a current temperature measurement,[102] the Court added to the language of *Gottschalk*. Holding the claim invalid under the product of nature doctrine, the *Parker* Court described a third concern that while the claim did not fall into the impermissibly abstract and sweeping category, it nevertheless failed to qualify as inventive subject matter because the only inventive contribution was to discover and apply a mathematical relationship that had always existed.[103]

Although the product of nature doctrine at best describes a fuzzy category of exclusions, at least three concerns behind the product of nature doctrine emerge from these cases: hindrance, necessity, and democratic ideals. Hindrance is the clearest of the three. All of the cases involving the doctrine express in some way a concern that patenting some subject matter will grant a monopoly that is too broad, thus hindering progress.[104] Some of the examples given by the Court (gravity and Einstein's mass/energy equation)[105] are clearly subjects that implicate, if not everything in the universe, certainly every invention made by man. Were a monopoly to be granted, funneling all future research across such a broad range of subjects through a single monopolist risks significant transaction costs and outright deterrence. The concern for necessity is less clear, but still important. Unlike hindrance, which is forward looking, necessity captures the Court's concern that the patent system should give incentive only where incentive is

100. *Id.* at 67–68.

101. 437 U.S. 584 (1978).

102. *Id.* at 585–86.

103. *Id.* at 593 & n.15.

104. *See* Lab. Corp. of Am. Holdings v. Metabolite Labs., Inc., 548 U.S. 124, 125 (2006) (Breyer, J., dissenting) ("We granted certiorari in this case to determine whether the patent claim is invalid on the ground that it improperly seeks to 'claim a monopoly over a basic scientific relationship' . . . ."); J.E.M. Ag Supply, Inc. v. Pioneer Hi-Bred Int'l, Inc., 534 U.S. 124, 135, 137 n.9 (2001) (stating that § 101 is interpreted broadly to keep from precluding developments in science and technology); Diamond v. Diehr, 450 U.S. 175, 188 n.11 (1981) (citing the Court's previous assertions that a patented invention of a natural phenomenon, including when a "process claim" is in question, must relate to the application of the phenomenon rather than the phenomenon itself); Diamond v. Chakrabarty, 447 U.S. 303, 319 (1980) (Brennan, J., dissenting) ("The patent laws attempt to reconcile this Nation's deep-seated antipathy to monopolies with the need to encourage progress."); *Flook*, 437 U.S. at 595 ("Neither the dearth of precedent, nor this decision, should . . . be interpreted as reflecting a judgment that patent protection of certain novel and useful computer programs will not promote the progress of science and the useful arts, or that such protection is undesirable as a matter of policy."); *Gottschalk*, 409 U.S. at 67–68 (applying the *Funk* principle that the discovery of a previously unknown natural phenomenon does not entitle someone to a monopoly); Funk Bros. Seed Co. v. Kalo Inoculant Co., 333 U.S. 127, 130 (1948) ("He who discovers a hitherto unknown phenomenon of nature has no claim to a monopoly of it which the law recognizes. If there is to be invention from such a discovery, it must come from the application of the law of nature to a new and useful end.").

105. *See supra* note 86 and accompanying text.

required for innovation. This concern is seen in the language of *Funk* dismissing Bond's innovation as mere application of existing natural phenomena.[106] Similarly, in *Flook* the lack of innovation inherent in simply applying a mathematical relationship was determinative.[107] The implication in both cases is that the incentive provided by patent protection is unnecessary to promote the minimal progress of science. Hindrance and necessity are both essentially economic concerns. The former embodies the concern that progress will be slowed by the granting of a broad monopoly; the latter represents the concern that resources will be wasted by giving incentives to capture what already exists to the detriment of true human innovation. The third concern, that for democratic ideals, however, is different.

The concern for democratic ideals is implicit rather than explicit in the Court's language. It is also a concern that does not rest on negative economic consequences. In *Funk* the Court described its examples of unpatentable subjects as "part of the storehouse of knowledge of all men."[108] *Chakrabarty* quoted *Funk* for the proposition that products of nature have the characteristic of being "'free to all men and reserved exclusively to none.'"[109] In one sense, these might be simply seen as conclusory statements—products of nature are free to all as a result of being declared unpatentable though it could be otherwise. However, I believe the Court is expressing a normative rather than a descriptive sentiment. These things are free to all because they *should* be free to all. In declaring that products of nature are part of the storehouse of knowledge, the Court is not expressing the legal consequences of the doctrine but rather describing the kind of subject matter that falls within the doctrine—a conception implicating democratic ideals, which are those ideals fundamental to our conception of a democracy: freedom of information, human dignity, and the effective functioning of society.

Many commentators have argued for a consequential defense of the product of nature doctrine, suggesting that private ownership of subject matter such as the theory of gravity or the substances found on the periodic table of elements has profoundly negative implications for human progress.[110] Consequential arguments can be further divided into those that are purely economic and directly engage the utilitarian defense of patents as incentive for innovation and those that do not concern harm to innovation but rather concern broader, noneconomic social consequences, such as the inequitable

106. *Funk*, 333 U.S. at 130–31.

107. *See Flook*, 437 U.S. at 597–98 (describing the algorithm in question).

108. *Funk*, 333 U.S. at 130.

109. *Chakrabarty*, 447 U.S. at 309 (quoting *Funk*, 333 U.S. at 130).

110. *See, e.g.*, Shulman, *supra* note 53, at 106 ("Today's privatization of knowledge assets—including genes and genetic information—threatens to choke productivity, magnify inequities, and erode our democratic institutions."); *see also* MATTHEW RIMMER, INTELLECTUAL PROPERTY AND BIOTECHNOLOGY 299–301 (2008) (summarizing the book's arguments for technology-specific patent law based on economic and other consequential concerns).

distribution of benefits or harm to the functioning of democracy. A second conception claims that private ownership of such subject matter is inherently wrong, whatever the consequences.[111] According to this conception, the laws of nature and natural phenomena have intrinsic meaning to society and humanity independent of the practical implications, and to grant private ownership would offend human dignity, our common heritage, or even God.[112] For now it is enough to note that the jurisprudence of the product of nature doctrine is best understood to be normative, i.e., intended to carve out some subject matter that *should* be reserved to humanity as a whole because of the concern both for economic consequences and for democratic ideals.

Whatever its contours, it is at least clear from *Chakrabarty* that the Supreme Court regards the product of nature doctrine as good law. Furthermore, because *Chakrabarty* was solely a question of patentable subject matter under § 101, it is also clear that the Court still considers the doctrine to constrain subject matter.[113] How then are genes—which occur naturally and are arguably manifestations of nature that should be free to all—nevertheless patentable subject matter? The answer lies in the isolation and purification doctrine.

B. Isolation and Purification

In 1911, Judge Learned Hand upheld patent claims for a concentrated form of an otherwise naturally occurring substance (Adrenaline) in *Parke-Davis & Co. v. H.K. Mulford Co.*[114] The patentee, Takamine, claimed his invention by reference to the characteristics of the substance that were obtained by applying a chemical process to a gland to extract the compound now known as Adrenaline.[115] In this way he asserted ownership over the chemical compound despite the fact that the compound existed in nature, bound together with other substances in that natural form.[116] Finding that the claimed substance was different both in chemical composition (because of the separation) and in therapeutic effect (because of the resulting

111. *See* RESNIK, *supra* note 24, at 74 ("Many opponents of DNA patents argue, however, that all DNA . . . is a product of nature, not a product of human ingenuity, and therefore should not be patented under any circumstances.").

112. *See id.* at 83 (summarizing three moral arguments against gene patents). A final line of reasoning suggests that ownership in such things is precluded as a practical impossibility—exactly how would one assert or enforce the right to exclude others from using the speed of light? This conception, however, is not very applicable to gene patents because it is not an open question whether enforcement is practical.

113. *But see* John M. Conley & Roberte Makowski, *Back to the Future: Rethinking the Product of Nature Doctrine as a Barrier to Biotechnology Patents (Part I)*, 85 J. PAT. & TRADEMARK OFF. SOC'Y 301, 319–20 (2003) (differentiating between pure subject-matter applications of the doctrine and applications related to novelty/nonobviousness).

114. 189 F. 95, 104 (C.C.S.D.N.Y. 1911), *aff'd in part and rev'd in part on other grounds*, 196 F. 496 (2d Cir. 1912).

115. *Id.* at 96–97.

116. *Id.* at 103.

concentration and removal of other substances), Judge Hand called these differences "not in degree, but in kind" and therefore patentable exceptions to the product of nature doctrine.[117] The isolation and purification doctrine has become particularly central to chemistry and, by extension, biotechnology patents.[118]

In 1958, the Fourth Circuit addressed the question of purification in *Merck & Co. v. Olin Mathieson Chemical Corp.*[119] The court held claims for vitamin B_{12} valid under the theory that the identification and extraction of the substance from liver resulted in a "new and useful . . . composition of matter" required by § 101 and therefore not a product of nature.[120] While liver had long been known to have beneficial effects in treating anemia, prior to the invention in question no one had explained these effects.[121] Some of the language in *Merck* suggests that the court used the product of nature doctrine in a conclusory sense—i.e., that "product of nature" is a label placed on subjects that fail to meet patentability requirements rather than an actual limit on patentability.[122] The court did not make a separate subject-matter analysis but instead tackled the inquiry as a question of novelty and utility, concluding that the invention met the statutory requirements because B_{12} did not exist as a separate substance before the invention and also provided a utility different in kind rather than degree.[123] While the court's analytic framework appears to be at odds with a proper understanding of the product of nature doctrine, the case does, nevertheless, provide insight as to why the patented invention is not a product of nature. First, the court found important the fact that the invention was for a previously unknown product.[124] Second, the effects of the purified B_{12} were different than those of any previously known compound (including the liver from which it was purified)—a difference in kind, not merely in degree of purity.[125]

It is possible to understand the isolation and purification doctrine in two different ways. It may be that the isolation and purification doctrine is an exception to the product of nature doctrine. It describes a set of

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117. *Id.*

118. *See* RESNIK, *supra* note 24, at 54 (discussing the isolation and purification doctrine and its application to the patentability of cloned DNA sequences).

119. 253 F.2d 156 (4th Cir. 1958).

120. *Id.* at 162 (citation omitted).

121. *Id.* at 158.

122. *See id.* at 161 ("There is nothing in the language of the Act which precludes the issuance of a patent upon a 'product of nature' when it is a 'new and useful composition of matter' and there is compliance with the specified conditions for patentability."). This does not square with the description the Supreme Court has given, which explicitly states that the doctrine is a limit on otherwise patentable inventions. *See supra* subpart III(A).

123. *Merck*, 253 F.2d at 164.

124. *Id.* at 162–63. Prior to the invention in question, it had been assumed in the art that the anti-anemic effects of liver could not be related to a vitamin compound. *Id.* at 159–60.

125. *Id.* at 164.

circumstances in which an invention is patentable *despite* the fact that the invention claimed is a product of nature.[126] One consequence of this conception is that the analysis of whether some invention is isolated or purified trumps the analysis of whether that invention is a product of nature. As an exception, it does not matter if the invention is a product of nature. Because "product of nature" is not a precise category, this conception has the advantage of avoiding a doctrinally difficult analysis. An invention that is isolated or purified is per se patentable subject matter, and there is no need for handwringing over whether it is a product of nature. However, convenient as it may be, I have a strong objection to treating the doctrine as an exception. As an exception, the isolation and purification doctrine becomes unmoored from its reasoning and is susceptible to formalism. Treating the doctrine as an exception does not capture the rationale behind both doctrines. If, as I have argued, the product of nature doctrine is not a positive description of a category but rather an expression of underlying concerns, then countervailing doctrines should address those concerns in some way. Rather than serving as an exception, the isolation and purification doctrine is better understood as a complementary refinement of the product of nature doctrine.

I have argued that the product of nature doctrine is a tool for addressing the concerns of hindrance, necessity, and democratic ideals. The isolation and purification doctrine can be better understood as helping to identify when those concerns are less likely to be present. First, on the concern of hindrance, the inventions found patentable through isolation or purification cover far less territory than the gravitational constant or the periodic elements or even the heat of the sun. In terms of necessity, both *Parke-Davis* and *Merck* upheld the patents in part because the inventions were found to have characteristics different in kind from anything that had previously existed. In other words, the patents properly served as incentives to create these characteristics that would otherwise not have existed. Again, the same cannot be said for the speed of light or naturally occurring elements. Whether or not this principle was correctly applied in those cases, its substance is still important.[127] Much less clear is how the isolation and purification doctrine relates, if at all, to democratic ideals. It is tempting to say that the doctrine helps identify subject matter that requires substantial effort to discover, and therefore private ownership is more justified. However, the concern for democratic ideals is not about justifying ownership in the individual case. Rather it asks whether that ownership—even when legitimate justification exists from an economic or moral rights standpoint—comports with our broader conception of society and humanity. I return to this question in

126. This is the typical characterization as reflected, for example, in the decision of the *Merck* court. *Id.* at 161.

127. The dividing line between a difference in degree and a difference in kind is not particularly clear, and one might plausibly argue that the increased utility or additional commercial viability alone should not be sufficient to push an invention into the latter category.

Part V, but for now it is enough to highlight that isolation and purification is better understood as a refinement of the product of nature doctrine based at least on the underlying concerns of hindrance and necessity.

In gene patents, isolation and purification is the hook on which the patentability rests.[128] Functional genetic information—those nucleotide sequences that find expression in the formation of proteins leading to identifiable traits through the process described in Part II—makes up only a small fraction, perhaps as little as 2%, of the DNA strands in the cells of most life on earth.[129] Scientists do not know what the other 98% of genetic material in the human genome is for,[130] but the fact that it exists at all turns out to be critical in understanding how individual genes are patentable. Because the chemical sequences that form functional genetic information are, in their "natural" state, chemically linked with nonfunctional nucleotide sequences,[131] it turns out that this information is patentable by way of the isolation and purification doctrine. The vast majority of sequences in human DNA are noncoding regions, or "introns."[132] Furthermore, the codons of a gene are often noncontiguous but rather interspersed with these noncoding regions.[133] Because of this fact, the typical gene claim covers a functional DNA sequence that has been isolated in the sense of being physically removed from its naturally occurring cellular context or purified in the sense of being composed of only the functional codons and none of the intervening introns.[134]

In 1991, the Federal Circuit upheld several claims in a gene patent in *Amgen, Inc. v. Chugai Pharmaceutical Co.*,[135] the broadest of which covered "[a] purified and isolated DNA sequence consisting essentially of a DNA sequence encoding human erythropoietin" (EPO).[136] In other words, this claim covered some DNA sequence that had *exactly the same properties* as

128. USPTO Utility Examination Guidelines, 66 Fed. Reg. 1092, 1093 (Jan. 5, 2001).

129. *The Science Behind the Human Genome Project*, *supra* note 38.

130. *See id.* (explaining that the remaining noncoding regions' "functions may include providing chromosomal structural integrity and regulating where, when, and in what quantity proteins are made").

131. *See id.* (detailing that "[t]he human genome contains 3164.7 million chemical nucleotide bases" and that "[r]epeated sequences that do not code for proteins ('junk DNA') make up at least 50% of the human genome").

132. *See id.* ("Less than 2% of the genome codes for proteins."); *see also Genome Glossary*, HUM. GENOME PROJECT INFO., http://www.ornl.gov/sci/techresources/Human_Genome/glossary/glossary_i.shtml (defining "intron" as a "DNA sequence that interrupts the protein-coding sequence of a gene; an intron is transcribed into RNA but is cut out of the message before it is translated into protein").

133. *The Science Behind the Human Genome Project*, *supra* note 38 ("Genes appear to be concentrated in random areas along the genome, with vast expanses of noncoding DNA between.").

134. Conley, *supra* note 62, at 116. Conley points out that, in the context of gene patents, isolation and purification essentially collapse into the same thing. *Id.* at 117.

135. 927 F.2d 1200 (Fed. Cir. 1991).

136. *Id.* at 1204.

the naturally occurring sequence—purification and isolation may change the chemical composition, but they do not result in characteristics different in kind. The use of the term "purified and isolated" had, at that point, achieved talismanic properties as far as gene patents were concerned.[137]

Arguably, the isolation and purification doctrine has long been detached from the rationale behind it and succumbed to formalism as a result of its application as an exception.[138] In *Parke-Davis*, Judge Hand held that the doctrine permitted the patent on purified adrenaline because the purified form had properties different in kind from the unpurified form and, furthermore, the claimed utility flowed directly from the differences.[139] I have argued that the doctrine provides help applying the product of nature doctrine by distinguishing inventions that do not implicate the underlying concerns of hindrance, necessity, and democratic ideals. However, as *Amgen* shows, at this point it is the mere isolation or purification of the chemical in a plausible linguistic sense that removes it from the product of nature doctrine, not any underlying characteristic of the invention.[140] The counterargument is that isolation of the gene does provide utility—you cannot use a gene *in situ* (i.e., in DNA inside the human body) in a laboratory test. However, this mischaracterizes the meaning of utility in the context of purification and isolation. Despite the language of the *Merck* court, the usefulness required for subject-matter eligibility is not the same as § 103 utility. The Supreme Court in *Funk* did not base its holding on the claim that the mixture of root-nodule bacteria failed to be useful. Rather, the Court held that the utility flowed almost entirely from the natural property of the bacteria and that the invention by Kalo to take advantage of that property in mixing the nodules together did not rise to the level of invention but merely consisted of recognizing and taking advantage of "a hitherto unknown phenomenon of nature."[141] Similarly, the Court in *Chakrabarty* offered no support for the

137. *See* Conley, *supra* note 62, at 116 ("[B]y 1991, the Federal Circuit had acquiesced in the proposition that the words 'purified and isolated' were sufficient to distinguish a claimed gene from its naturally occurring counterpart.").

138. A 2006 comment in the *Temple Law Review* shows just how malleable the doctrine might be. *See* Peter Fox, Comment, *It's Not Over for the Product of Nature Doctrine Until the Synthetic Super-Heavy Element ("SHE") Sings*, 79 TEMP. L. REV. 1005, 1019–20 (2006) (suggesting that elemental particles made in the confines of particle accelerators and otherwise unknown in nature should be patentable despite the product of nature doctrine in part by arguing that the purification exception for gene patents implies a particularly narrow product of nature doctrine); *see also* U.S. Patent No. 3,156,523 (filed Aug. 23, 1946) (granting a patent for periodic element 95, previously unknown in nature except by the process disclosed in the patent).

139. Parke-Davis & Co. v. H.K. Mulford Co., 189 F. 95, 103 (C.C.S.D.N.Y. 1911).

140. Conley, *supra* note 62, at 116.

141. Funk Bros. Seed Co. v. Kalo Inoculant Co., 333 U.S. 127, 130 (1948). *But see* Jack Wilson, *Patenting Organisms: Intellectual Property Meets Biology* (criticizing the doctrine as providing an unreliable standard and noting that Justice Frankfurter's concurring opinion in *Funk* rejected the "work of nature" label as "vague and malleable" (quoting *Funk*, 333 U.S. at 134–35 (Frankfurter, J., concurring))), *in* WHO OWNS LIFE?, *supra* note 24, at 25, 31–32.

assertion that utility alone could trump the product of nature doctrine, whatever the doctrine's bounds.[142]

This brings me to the viability of arguments against patentability of genes in the face of the current state of the law. In Part IV, I survey the more traditional economic objections to gene patents, which I argue are well represented in the product of nature concerns for hindrance and necessity. These seem to be the more persuasive arguments in the current discourse, perhaps because these concerns are so clearly connected to the product of nature doctrine.[143] Part V tackles the noneconomic moral concerns and argues that they too are aligned with the product of nature doctrine in its concern for democratic ideals.

IV. Economic Incentives and the Product of Nature Doctrine

Although there are many different justifications for intellectual property, the most commonly understood reason behind the U.S. patent system is to spur progress in science and the useful arts.[144] Progress is commonly accepted to be a social good, and monopoly protection—in the limited sense as provided in the intellectual property context—is required in order to maximize that good by providing economic incentive to inventors and innovators and also to potential investors to fund such invention and innovation.[145] Without this monopoly, inventors would be unable to capitalize on their work because competitors would free ride on the up-front investments of capital and labor.[146] The basic argument applies to all innovation and creation, but biotechnology-industry advocates, such as Claude Barfield and John Calfee of the American Enterprise Institute, have argued that biotechnology is in particular need of strong intellectual property protections.[147] Although they do not concentrate on gene patents in particular, Barfield and Calfee argue that the case for IP protection in biotechnology is strong because (1) biotechnology as a field is significantly advanced by disclosure of research, and such disclosure will not happen in the absence of IP protection;[148] (2) the biotechnology market consists mainly of many small businesses that would not be viable without IP protection

142. Some of the examples the Court gives of excludable subject matter—the laws of gravity and relativity—would appear significantly more useful than Chakrabarty's bacterium.

143. Indeed, these are the arguments advanced in *Ass'n for Molecular Pathology* and considered by Judge Sweet in his decision. Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 702 F. Supp. 2d 181, 206 (S.D.N.Y. 2010) (discussing the plaintiff's contention that the patent has hindered research).

144. *See* RESNIK, *supra* note 24, at 34–37 (surveying the utilitarian and natural-rights justifications for intellectual property law).

145. *Id.*

146. BOHRER, *supra* note 32, at 71–72.

147. BARFIELD & CALFEE, *supra* note 24, at 29–30.

148. *Id.*

because they own little else, and the prospect of venture capital or partnerships with established companies would otherwise be slim;[149] and (3) the uncertainty of commercial viability owing to the infancy of the art requires prospecting behavior that can only be ensured by strong IP rights early in the research process.[150] Whether these arguments are persuasive or not, one thing is clear: the biotechnology industry as it currently exists relies heavily on patents.[151] Art Levinson, the CEO of Genentech until 2009, told Congress in 2000 that "[p]atents are the lifeblood of the biotech industry and are crucial to spurring innovation."[152]

Even if one accepts the claim that patent rights in general are necessary to spur innovation in biotechnology because of the nature of the business, that does not answer the question of *which* patents are necessary. A monopoly is not without costs, and the requirements of patentability are meant to help ensure that the costs are properly balanced.[153] As I have argued, one of those requirements—subject matter—excludes products of nature in part because of the concern for economic costs.

A. Hindrance and Necessity: Economic Concerns

There are at least two criticisms of the standard economic defense of intellectual property that commentators have argued are particularly relevant in biotechnology: (1) that intellectual property protection actually retards innovation by increasing transaction costs and introducing holdup problems and (2) that even if biotechnology patents do provide some marginal incentive, that incentive is neither necessary nor justified.[154] Both criticisms

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149. *Id.* at 17.

150. *Id.* at 30–31. *But see* ALBRIGHT, *supra* note 24, at 144–48 (comparing the current biotechnology industry to the aerospace industry in its infancy and noting the significant role of government regulation in solving a problem created by a surfeit of patents). Albright goes on to suggest that the rapid development of other nascent technologies in U.S. history owes a lot more to government-enabled cooperation than to intellectual property protections. *Id.* at 149.

151. A 2000 study of market capitalization as a function of patent portfolios among biotechnology firms found that patents accounted for a significant portion of capitalization, with individual patents, like those involving recombinant DNA, accounting for an estimated $12.6 million in value. David H. Austin, *Patents, Spillovers, and Competition in Biotechnology* 17 (Resources for the Future, Discussion Paper No. 00-53, 2000). Austin noted that his estimates were much higher than those of previous studies (involving more industries) and attributed his findings to the unusual importance of patents in biotechnology. *Id.* at 20; *see also* Stuart J.H. Graham et al., *High Technology Entrepreneurs and the Patent System: Results of the 2008 Berkeley Patent Survey*, 24 BERKELEY TECH. L.J. 1255, 1277 (2009) (reporting survey results indicating that 75% of biotechnology startups hold patents with an average of 9.7 patents per firm—second only to medical device companies).

152. Press Release, Genentech, Genentech CEO Says Amgen/TKT Trial Outcome Not a Bellwether for Biotech (July 13, 2000) (internal quotation marks omitted), *available at* http://www.gene.com/gene/news/press-releases/display.do?method=detail&id=4624.

153. *See supra* notes 67–69 and accompanying text.

154. For example, one 2003 survey of medical lab directors in the United States found that 25% of the respondents indicated that they had stopped offering a genetic test as a result of being contacted by a related patent holder or licensee. Mildred K. Cho et al., *Effects of Patents and*

can be tied to the constitutional basis for the patent system under the theory that the monopoly grant is not a legitimate exercise of congressional power because it does not sufficiently advance the goals of the enumerated power "[t]o promote the Progress of Science and useful Arts."[155] The former criticism was made famous in the context of biotechnology research in an article by Michael Heller and Rebecca Eisenberg, arguing that patent rights too far upstream from commercially viable products create an anticommons of stacked and overly broad property rights that retards innovation.[156] Whether or not anticommons concerns are significant in biotechnology is a topic of much debate, with many scholars suggesting that what little empirical evidence exists is equivocal at best.[157] This Note does not directly engage the economic-incentive justification for gene patents. The main point I wish to extract is that these practical concerns align with the product of nature doctrine and support my argument that it is a normative, rather than descriptive, doctrine. To the extent gene patents have anticommons effects, the patents implicate the product-of-nature-doctrine interest in avoiding hindrance. Furthermore, to the extent the marginal incentive to innovate is unjustified, gene patents implicate the doctrine's concern for necessity. This second concern deserves some further discussion.

Patent rights in functional genetic information may be unnecessary in at least two ways. First, patent protection is unnecessary when other economic incentives exist for research and development of this particular kind of innovation—identifying the location, composition, and functions of specific genes. Second, patent protection is unnecessary when other noneconomic incentives exist within the academic and governmental communities responsible for a great deal of research into functional genetic information.

The gene is not an end product. In fact, it is often at the very beginning of commercial research and development. In their defense of the status quo,

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Licenses on the Provision of Clinical Genetic Testing Services, 5 J. MOLECULAR DIAGNOSTICS 3, 5 (2003). A full 53% indicated that they had opted against developing or performing a specific test as a result of extant patent rights. *Id.*

155. U.S. CONST. art. I, § 8, cl. 8. This argument is made, for example, in the *Ass'n for Molecular Pathology* complaint. Complaint at 29, Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 702 F. Supp. 2d 181 (S.D.N.Y. 2009) (No. 09 CV 4515).

156. Michael A. Heller & Rebecca S. Eisenberg, *Can Patents Deter Innovation? The Anticommons in Biomedical Research*, 280 SCI. 698, 698 (1998).

157. Since Heller and Eisenberg described the concept of an anticommons problem, scholars have debated whether biotechnology patents have actually had such an effect. *See* Caulfield, *supra* note 6, at 135–40 (arguing that the evidence of downstream harm resulting from gene patents on research and clinical care is mixed at best and further noting that the negative consequences are trade-offs inherent in the structure of patent law that should be evaluated against the incentives, not in isolation). *But see* Rebecca S. Eisenberg, *Noncompliance, Nonenforcement, Nonproblem? Rethinking the Anticommons in Biomedical Research*, 45 HOUS. L. REV. 1059, 1075–76 (2008) (conceding that some current data do not support concerns about the effects on research but maintaining that anticommons problems may still exist with regard to downstream commercial products).

Barfield and Calfee describe the expensive and risky proposition of therapeutic research and development, dividing it into stages: from initial targeting of a specific biological pathway through sequence through regulatory compliance.[158] In their conception, the "usable form"—e.g., a drug, diagnostic test, or therapy—does not materialize until the second stage of development.[159] The functional genetic information is only a springboard, and what is even more interesting about their description of the process is that the bulk of the risk and expense associated with commercializing biotechnology comes not at the DNA research stage but much later during the "arduous" preclinical and clinical tests.[160] By implication, there is relatively low cost (both in time and capital) in the work of identifying new genes when viewed in the context of the entire life cycle.[161] Inherent in this description of the product life cycle is the promise of a product at the end of that life cycle. That product is itself the proper object of patent protection. No one (or, at least, no one writing this Note) argues that the compositions of matter that are drugs, diagnostic tests, and other therapies should be excluded from patentable subject matter.

Patent protection is clearly not required at every incremental stage of product development. Companies routinely make investments in research and development where it is recognized that benefits flow from the discovery of new information.[162] While an organization might need the prospect of a patent to protect the commercialization of basic research, exclusive rights in

158. BARFIELD & CALFEE, *supra* note 24, at 15–16.

159. *Id.* at 16.

160. *Id.* at 16–17.

161. This may be a function of advances in science. What was once an arduous and uncertain search to identify even a single gene in 1982 is now almost routine thanks in no small part to the Human Genome Project, which created a raw map of human DNA. *See* John M. Golden, *Biotechnology, Technology Policy, and Patentability: Natural Products and Invention in the American System*, 50 EMORY L.J. 101, 114–15 (2001) (noting the increasingly routine nature of DNA isolation and sequencing). Because codons, the three-nucleotide sequences that code for specific amino acids, are well-known, it is trivial to scan the genome database to find a promising location for a gene amid the 98% of noncoding DNA by looking for areas of sequential codons. Furthermore, as the state of the art grows increasingly sophisticated, the methods for predicting protein formation, chemically isolating specific segments, and performing other steps in the research process become more routine as well. This has implications for the patentability of genes, beyond the scope of this Note, in the nonobviousness requirement of patent law. *See* 35 U.S.C. § 112 (2006) (establishing the requirements for what must be set out in a patent application to meet the nonobviousness requirement). In Part VI, I briefly discuss the alternative proposal that concerns about gene patents are best handled by statutory patentability requirements other than subject matter. For a discussion of how a recent Supreme Court ruling on the nonobviousness standard may lead to a more stringent requirement in the field of biotechnology, see Ying Pan, Note, *A Post-*KSR *Consideration of Gene Patents: The "Obvious to Try" Standard Limits the Patentability of Genes*, 93 MARQ. L. REV. 285 (2009).

162. *See* Ammon J. Salter & Ben R. Martin, *The Economic Benefits of Publicly Funded Basic Research: A Critical Review*, 30 RES. POL'Y 509, 511 & n.4, 520 (2001) (describing the economic and noneconomic benefits accruing from publicly funded open research and also noting the participation of business groups in public research).

the research itself are unnecessary.[163] Of course, this does not mean that incentive is not required even at this early stage, but it does suggest that the required incentive might be somewhat less than the full monopoly right arguably needed to protect the entire research cycle. This brings us to the fact that, despite the trumpet call that monopoly protection is the only incentive for innovation, there are other forces driving research.

Research universities, which have their own incentives different from commercial concerns, are involved in a significant portion of biotechnology research.[164] The norms of the academic community provide a different set of incentives of prestige and notoriety for basic research. In 2001, John Golden explored the territory of incentives among academics in general and life sciences in particular.[165] Golden identified three tiers of "public sector values" that motivate researchers: idealistic, self-focused, and career benefiting.[166] In the first tier are values such as the desire to advance science and contribute to the community.[167] In the second is the personal sense of satisfaction that comes from solving an interesting problem or besting a colleague or competitor in research.[168] The final tier encompasses the more crass motivations associated with the academic world, such as establishing preeminence and gaining the seniority required for research independence.[169] Golden argues persuasively that these motivations provide strong reasons to question the need for patent rights on life-sciences research and also to question the effects that granting such rights might have on these alternative motivations.[170]

Chakrabarty's own case is somewhat illuminating in this regard. In an article recounting the circumstances of the seminal case, Dr. Chakrabarty himself casually offers the standard economic justification for patent protection: "If this organism was not protected by a patent, anybody could easily isolate it and use it for oil cleanup purposes."[171] What is interesting to

163. Furthermore, alternative means of protecting research exist, for example, through trade-secret protection. *See* Graham et al., *supra* note 151, at 1312–13 (surveying venture company reasons for not filing patent protection, specifically noting disclosure as a deterrent, and discussing the adequacy of trade-secret protection as a viable option). Of course, the ability to avoid disclosure does not comport with the argument that genetic information should be "free to all," but this fact does indicate that the prospect of patent rights alone is not necessarily the driving force behind innovation. *See id.* at 1288–90 (discussing data questioning the effect of patent ownership as an incentive to innovate).

164. *See* Jensen & Murray, *supra* note 19, at 239 (listing the University of California among the top ten gene patent assignees in the world).

165. Golden, *supra* note 161, at 152–59.

166. *Id.* at 153.

167. *Id.* at 153–54.

168. *Id.* at 155–56.

169. *Id.* at 156–57.

170. *Id.* at 174–77.

171. A. M. Chakrabarty, *Patenting of Life-Forms: From a Concept to Reality*, *in* WHO OWNS LIFE?, *supra* note 24, at 20. An interesting side note, mostly lost to history, is the curious fact that

note, however, is that this concern—and the impetus to seek a patent—occurred to Chakrabarty *after* he had been independently induced by conversations with his co-workers and his own keen interest in the science to spend his time "after-hours and [on] weekends . . . tinkering with [the bacterium]."[172] This is not to say that the commercial viability of a project (which arguably depends on patent protection) does not provide necessary incentive for research. To the contrary, it provides clear incentive. My point is only that there are several other incentives that drive motivation, including sheer intellectual curiosity, which may be improperly discounted in the economic argument for intellectual property rights.

Functional genetic information is special. It is fundamental to entire fields of science such that some have argued patent rights hinder downstream innovation. Functional genetic information is also unquestionably valuable even without the possibility of exclusive ownership. There are a large number of organizations and individuals driven to investigate these fundamental building blocks of human life both for high-minded academic and practical commercialization reasons, raising doubt as to the necessity of an exclusive property right to provide incentive to innovate. These arguments against gene patents align with the product of nature doctrine's concerns for hindrance and necessity, suggesting that functional genetic information falls within the boundaries of the doctrine. The next Part argues that functional genetic information also implicates the third concern of the doctrine—democratic ideals.

V. Moral Objections and the Product of Nature Doctrine

Presume for the moment that on balance the economic arguments in favor of patent protection for functional genetic information prevail. In other words, the pace and quality of innovation in identifying the location and function of specific genes will be substantially increased by providing a monopoly right, and this increased innovation will outweigh the countervailing anticommons costs. If the product of nature doctrine were meant to exclude the grant of patents on subject matter only when such a grant would hinder progress because of an overly broad scope or by unnecessarily encouraging innovation where none is needed, then evidence that gene patents implicate neither concern would remove the argument that such patents should be excluded under the product of nature doctrine. However, there is a third concern of the doctrine: the concern for democratic ideals.

Whether or not the pace of innovation in biotechnology is enhanced by gene patents is, of course, only one of the concerns of a monopoly right. There are other social costs as well, such as the effect on academic freedom

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Chakrabarty's invention turned out not to have had significant commercial value after all. The bacterium did not perform in nature as it had in the lab. ALBRIGHT, *supra* note 24, at 74–75. Of course, this is not to say that the prospect of a patent did not serve as an incentive for the invention.

172. Chakrabarty, *supra* note 171, at 18–19.

and inequity in the access to treatments and the delivery of health care. These consequences might outweigh the benefits of the incentive. In addition there are objections that flow not from negative consequences but rather from the inherent wrongness of gene patents. I argue that these objections align with the third underlying concern of the product of nature doctrine, democratic ideals. Furthermore, the characteristics of functional genetic information—essentialness, expression independence, and self-reference—explain how the moral concerns for genes implicate those democratic ideals.[173] The controversy surrounding Myriad Genetics provides a lens through which to view these arguments.

A. The Myriad Controversy

In the spring of 2009, the ACLU, naming twenty plaintiffs, filed a lawsuit in the Southern District of New York naming the USPTO, Myriad Genetics, and ten directors of the University of Utah Research Foundation as defendants.[174] The suit concerned two genes related to breast cancer in women, BRCA1 and BRCA2.[175] The plaintiffs requested a declaratory judgment as to the invalidity of sixteen claims across seven different patents.[176] All seven patents were assigned to Myriad Genetics, Inc., a Utah-based company specializing in "molecular diagnostics."[177] Myriad was founded in the early 1990s and from the beginning based its business model primarily on the development and acquisition of intellectual property rights.[178] Myriad sponsored research that isolated the location and sequence of BRCA1 and BRCA2 and applied for several patents covering both compositions of matter and methods of use (process).[179] Per its business plan, Myriad proceeded to develop commercially viable diagnostic tests to detect the presence of BRCA1 and BRCA2 mutations that correlate with an increased risk of cancer.[180]

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173. *See supra* subpart II(A).

174. Complaint at 1, Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 669 F. Supp. 2d 365 (S.D.N.Y. 2009) (No. 09 CV 4515).

175. *Id.* at 2.

176. *Id.* at 30.

177. *About Myriad*, MYRIAD GENETICS, http://www.myriad.com/about/.

178. RIMMER, *supra* note 110, at 187. Rimmer quotes the CEO of Myriad defending the need for patent rights to attract investment: "If it's not patented you won't get some group to spend money to develop it, and you won't get a high-quality, inexpensive test." *Id.* at 188; *see also* ALBRIGHT, *supra* note 24, at 78–86 (criticizing the scare tactics of Myriad and questioning the statistics behind the claims).

179. RESNIK, *supra* note 24, at 159–60. There is some disagreement as to the contribution made by Myriad to the basic genetic research, with some evidence indicating that the majority of the work was publicly funded research for which Myriad nevertheless received exclusive rights. Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 702 F. Supp. 2d 181, 203–04 (S.D.N.Y. 2010).

180. RESNIK, *supra* note 24, at 159.

Myriad was aggressive in commercializing patents. In 1996, Myriad introduced its first genetic test for the detection of the presence of the BRCA genes and chose to license this test to only a small number of laboratories in an effort to restrict competition. Myriad's licensing terms for the tests were also viewed by some practitioners as excessively restrictive, compromising the ability to offer effective tests.[181] Furthermore, from the beginning Myriad refused to license its patents in the underlying genes themselves, which prevented competitors from developing alternative tests.[182] This type of conduct was perceived as having many potentially negative effects: precluding any increase in affordability from competition, precluding development of a more effective test by a competitor, and stifling follow-on research on the genes (even that unrelated to genetic testing).[183] Myriad sent a barrage of cease-and-desist letters to laboratories across the world, a move that critics say brought those negative effects to fruition because cheaper and more effective tests were clearly under development, even in use, and the letters went indiscriminately to competitors and academic researchers alike.[184]

Among the patent claims challenged in the *Ass'n for Molecular Pathology* suit are ten composition-of-matter claims, all of which use the term *isolated* and fall into the category of functional genetic information. A representative claim, claim 1, from the '282 patent reads: "An isolated DNA coding for a BRCA1 polypeptide, said polypeptide having the amino acid sequence set forth in SEQ ID NO:2."[185] The patent defines an isolated nucleic acid (which it implies is synonymous with "substantially pure") as "one which is *substantially separated* from other cellular components which naturally accompany a native human sequence or protein."[186] In other words, the term covers every single nucleotide sequence matching the one described by SEQ ID No. 2 wherever it exists and however it came to exist, so long as it is not attached to other components with which it is normally found.[187] Furthermore, "the term embraces a nucleic acid sequence or protein which has been removed from its naturally occurring environment and [also]

181. *Ass'n for Molecular Pathology*, 702 F. Supp. 2d at 209–10.

182. *See* Robert Cook-Deegan et al., *Impact of Gene Patents and Licensing Practices on Access to Genetic Testing for Inherited Susceptibility to Cancer: Comparing Breast and Ovarian Cancers with Colon Cancers*, GENETICS MED., Apr. 2010, at S15, S28 ("[Myriad's ambiguous patent enforcement policy] may itself stifle basic or clinical research as researchers either avoid the work altogether or are wary of publicly reporting results.").

183. *See* Ann Weilbaecher, *Can Patent Protections Trample Civil Liberties? The ACLU Challenges the Patentability of Breast Cancer Genes*, 15 LOY. PUB. INT. L. REP. 10, 12 (2009) (noting the ACLU's argument that Myriad's decision to enforce their licenses strictly has "thwarted research and access to diagnostic testing").

184. Caulfield, *supra* note 6, at 142.

185. U.S. Patent No. 5,747,282 col.153 *ll.*57–59 (filed June 7, 1995).

186. *Id.* at col.19 *ll.*10–12 (emphasis added).

187. Furthermore, the BRCA genes have over 450 known mutations, and Myriad's claims grant the company the right to exclude use (including research) of each and every one. ALBRIGHT, *supra* note 24, at 85.

includes [both] recombinant or cloned DNA . . . and chemically synthesized analogs or analogs biologically synthesized."[188] Thus defined, the term *isolated* means both physically separated *and* synthetically created chemicals and, more importantly, chemicals that are *functionally indistinguishable* from their "naturally occurring counterparts." In this regard, the patent is very similar to the one upheld in *Amgen*.[189]

In fact, what is most remarkable about the Myriad "isolated DNA" claims is just how unremarkable they are. They are representative of the typical gene patent encompassing functional genetic information. Why would the ACLU and its fellow plaintiffs argue so fervently against the validity of these patents when they have been upheld for so long? Part of the argument lies in the behavior of Myriad—one could perhaps not have invented a better poster child for the alleged dangers of abuse inherent in the corporate ownership of genes. But the ACLU suit aims to invalidate all gene patents and in doing so reflects moral concerns about the consequences of gene patents and the inherent importance of genetic information that go far beyond the allegedly abusive behavior of a single corporate actor.

B. Democratic Ideals: Noneconomic Moral Concerns

I have argued that the product of nature doctrine is concerned with more than just the economic consequences of granting patents over certain subject matter. It is also concerned with subject matter implicating democratic ideals. It turns out that those democratic ideals—openness of information, human dignity, and functioning of society—are implicated by the noneconomic moral objections to gene patents.

Moral concerns for gene patents can be divided into two categories: consequential and inherent. In the former are the various noneconomic social costs that weigh against the granting of a monopoly in this subject matter. In the latter are more abstract concerns, those less about tangible consequences and more about the nature of ownership of functional genetic information. Both categories are important to understanding why gene patents encompassing functional genetic information generate moral objections. And both are represented in the product of nature doctrine, helping explain why the isolation and purification doctrine is misapplied in the case of functional genetic information.

Consequential moral objections to gene patents are numerous and varied. Innovation in the context of biotechnology has consequences beyond the intrinsic value of the progress of science. We are also concerned with the functioning of the health care system. In the Myriad case in particular, the

188. *Id.*

189. *See* Amgen v. Chugai Pharm. Co., 927 F.2d 1200, 1205–15 (Fed. Cir. 1991) (upholding U.S. Patent No. 4,703,008 (filed Nov. 30, 1984)).

negative effects on health care are often highlighted.[190] Critics have charged that patents on genes—and Myriad's behavior in particular—lead to increased cost and decreased quality of care.[191]

A second consequential objection involves the effects on the biotechnology research community.[192] Restriction of the free flow of information, the argument goes, chills academic freedom and the positive culture of openness and integrity. Along similar lines, it has been argued that gene patents have implications for the functioning of our larger society.[193] By granting ownership in functional genetic information, we remove vital information from the purview of the general populace, resulting in a less than optimally informed populace. Critics of these objections point out that, contrary to restricting information, patent law's disclosure requirement actually increases the dissemination of information and the exclusive right is only in the embodiment, not the abstract information.[194] However, as I have argued, functional genetic information has the somewhat unique characteristic of self-reference, and the right to control the manufacture and use of the chemical embodiment of functional genetic information grants much broader control over the abstract information than otherwise might normally be the case, perhaps outweighing the benefits of disclosure through the patent-publication system.

Another consequential argument points to the downstream ethical problems of other conduct that arguably flows from gene patents. Without a clearly defined bar, gene patents form the basis of a rationale that leads to the patenting of higher forms of life.[195] Even if we do not anticipate significant

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190. *See, e.g.*, Complaint at 18–19, Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office, 669 F. Supp. 2d 365 (S.D.N.Y. 2009) (No. 09 CV 4515) (arguing that the breadth of Myriad's patents interferes with the development of new tests for breast and ovarian cancers and prevents women from giving blood to a researcher or clinician for a second opinion).

191. ALBRIGHT, *supra* note 24, at 86. Albright also offers a more related but subtler argument—that the grip of genes on the popular imagination (what I call essentialness) allows purveyors of genetic tests to overstate the value of genetic testing and profit off of public fear. *Id.* at 87.

192. This is distinct from the effects on the research itself as discussed *supra* in Part IV.

193. *See, e.g.*, Rebecca S. Eisenberg, *Proprietary Rights and the Norms of Science in Biotechnology Research*, 97 YALE L.J. 177, 180 (1987) (noting that, despite the "substantial parallels" between intellectual property rights and scientific norms in the biotechnology context, intellectual property rights may nevertheless cause delays in the dissemination of research and "aggravate inherent conflict between the norms and the reward structure of science"); Arti Kaur Rai, *Regulating Scientific Research: Intellectual Property Rights and the Norms of Science*, 94 NW. U. L. REV. 77, 79–80 (1999) (arguing that in certain contexts, the instrumental goals of intellectual property are better served not by the strengthening of intellectual property rights but by scientific "norms that militate *against* the securing of such rights").

194. *See* Wetkowski, *supra* note 24, at 202 ("[I]t is more likely that banning gene patents would create a 'tragedy of the commons' scenario, where research is abandoned because no one would have sufficient protection for the resulting intellectual property that would justify investment in the technology").

195. *See* Ari Berkowitz & Daniel J. Kevles, *Patenting Human Genes: The Advent of Ethics in the Political Economy of Patent Law* (quoting Andre Kimbrell, policy director for the Foundation

direct harm from gene patents, the argument goes, the patenting of higher life forms raises ethical concerns of individual dignity, treatment of animals, and even slavery. This argument is not the most persuasive—first it suffers from the defect of many slippery-slope arguments that, while the incremental steps may be indistinct, there is still a clearly identifiable gap between the incident case and the feared result. One suspects that a line could be drawn without too much trouble. Second, the subject matters in question are different enough that it is unfair for the field of genetic information to be tainted by linkage with the idea of ownership of higher forms of life (which implies moral questions about treatment of those life forms not at issue with DNA). Even if the argument is not persuasive, however, it is useful in showing that the essentialness of genetic information implicates far more than just DNA molecules. Human DNA is not a human being, but the former relates to the latter in a way that a simple carbon molecule does not.

Although the consequential arguments are more commonly made (perhaps because they meet the utilitarian justification for patents on common ground), there are arguments against gene patents based not on supposed negative economic or social consequences but on the belief that the very notion of private rights to something so basic is itself inherently repugnant. Two bases for the argument of inherent repugnance, common heritage and human dignity, closely track the democratic ideals concern of the product of nature doctrine.

The argument that DNA is the common heritage of humanity takes on two forms.[196] The first is by direct analogy to the common law doctrine that certain resources, such as the air and the oceans, belong to humanity as a whole and cannot be subject to private rights.[197] In this form, common heritage argues that our constituent genes are literally, not figuratively, possessed by all of humanity and therefore are literally property that is common to us all.[198] This form of the argument is problematic. First, genetic information, though intimately bound to the chemical expression, is still an abstraction that defies physical possession. Second, because functional genetic information is not unique to humanity but is found in all living things, literal exclusive possession by humanity alone is an inaccurate conception even if it were possible. A second form of the common heritage argument is more compelling. In this conception, rather than possession, the argument is

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on Economic Trends, expressing this fear while testifying to the Senate), *in* WHO OWNS LIFE?, *supra* note 24, at 75, 84–85.

196. RESNIK, *supra* note 24, at 77–82.

197. For a more detailed analysis of the common heritage doctrine and its relationship to gene patents, see Melissa L. Sturges, Note, *Who Should Hold Property Rights to the Human Genome? An Application of the Common Heritage of Humankind*, 13 AM. U. INT'L L. REV. 219, 245–52 (1997).

198. RESNIK, *supra* note 24, at 78.

based on the responsibility implied by the existence of a common resource.[199] While we may not be in literal, physical possession of our functional genetic information, we can conceive of the knowledge contained in DNA and related molecules as a resource of common benefit and significance to humanity as a whole. This conception is arguably flawed because of the nonexclusive and nonexhaustive nature of genetic information (and intellectual property in general). The common heritage of the oceans and air is firmly grounded in physical property law and the concern for overuse of a common resource—the tragedy of the commons.[200] In contrast, functional genetic information, like intellectual property, is not subject to exhaustion, nor does use by one person necessarily imply exclusion of others. However, as I have argued, functional genetic information is intimately bound to the chemical expression of that information (self-reference). This means that an exclusive right in that chemical expression could implicate availability of the abstract information for common practical use.

The second argument of inherent moral repugnance is that ownership of genetic information offends human dignity.[201] This argument stems from the commodification of fundamental parts of humanity.[202] The fact that patents are granted in the context of commerce and profit violates the moral imperative originating with Kant that human beings should be treated as ends in themselves, rather than mere means.[203] One response to this argument is that gene patents commodify not a human being or other organism but at most a discrete part that does not have the same characteristics of autonomy and selfhood.[204] The offense against human dignity in gene patents is, admittedly, not entirely analogous to ownership of a human being. However, the negative reaction to the commodification of genetic information draws out the essentialness of genes. Even if it is inaccurate to analogize genetic information to human beings and a mistake to reduce a human being to his constituent genes, the fundamental connection between genes and human life is unmistakable, and we should be more wary of granting ownership than in the case of patents on other chemical compounds.

Given the state of the law with regard to gene patents, it is clear that none of these moral concerns has had the strength to carry the day with

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199. *See* RESNIK, *supra* note 24, at 81–82 (analyzing the argument that humanity has a "basic moral duty" to "take care of the earth's resources to ensure that they are available to future generations").

200. Garrett Hardin, *The Tragedy of the Commons*, 162 SCI. 1243, 1245 (1968).

201. *See* RESNIK, *supra* note 24, at 100–05 (discussing the notion that "DNA patents violate human dignity" by "treat[ing] human beings as complete commodities, as mere things with commercial value but with no intrinsic moral worth").

202. Hanson, *supra* note 24, at 167–69.

203. *Id.* at 168.

204. RESNIK, *supra* note 24, at 113. But he goes on to suggest that there might be a more compelling consequential version of this argument that commodification leads to consequences that offend human dignity. *Id.* at 114–15.

policy makers and patent grantors. Yet the concerns persist. How has the legal doctrine succeeded in sidestepping these moral objections? The answer lies in the application of the purification and isolation doctrine, which purports to carve out patent protection only for isolated, non-naturally occurring chemicals and therefore does not implicate any of the consequential, common heritage, dignity, or commodification objections. While that may be true of most chemical compounds, I have argued that functional genetic information is a special case.

The purification or isolation line is drawn to give a property right only to the non-naturally occurring composition of matter while still preserving the public's right to use natural phenomena (including laws of nature). John M. Conley points out two problems with the assumption that functionally equivalent but isolated DNA is different in a way that is material to the product of nature doctrine—i.e., why isolation and purification does not successfully address the underlying concerns of the product of nature doctrine in the gene patent context. First, by granting dispositive status to isolation and purification, the court has effectively granted the patent holder "proprietary rights in genes and proteins whenever they are used outside the chemical media in which they naturally occur."[205] Because "genes are successfully defined both in terms of their sequences and the proteins they encode while proteins are defined both by the amino acids that comprise them and the DNA sequences that encode them," the patent right in functional genetic information captures the entire field of use, not just of the composition of matter described by certain sequences of nucleotides but of the fact that gene A produces protein B.[206] Conley's second argument brings the disconnect into closer focus. The utility of gene patents—the whole reason they are of any scientific or commercial interest—consists of the fact that what is claimed is "functionally indistinguishable from the natural version."[207] To put it another way, the properties of the patented "invention" are only useful by virtue of duplicating, without distinction, the natural properties of the gene.

Why do gene patents evoke these moral concerns? They do so, I contend, because of the characteristics of functional genetic information, which are also relevant to understanding genes as products of nature. Recall the three characteristics of functional genetic information I asserted above: essentialness, expression independence, and self-reference.[208] The information contained in genes is essential to an expansive array of human existence. Furthermore, this information goes far beyond the chemicals in which it is

205. Conley, *supra* note 62, at 119.

206. *Id.*

207. *Id.* at 120 (emphasis omitted).

208. *See supra* subpart II(A).

expressed. Genes have characteristics not found in the typical invention.[209] They are the basic building blocks of life. They can help answer questions fundamental to who we are, where we came from, and where we are going. A monopoly in this information, like a monopoly in the gravitational constant or the heat of the sun, is much broader and has many more consequences than a monopoly in a novel toaster. The essentialness and expression independence of functional genetic information thus invoke the moral concerns and also implicate the concerns of the products of nature. Proponents of gene patents (and the USPTO) argue that the claims in gene patents are for specific embodiments—the isolated and purified chemical—not for these essential, expression-independent ideas.[210] But as we have seen, the isolated and purified claims of gene patents are essentially indistinguishable, in terms of the functional genetic information, from the naturally occurring genes themselves. This is the self-referential characteristic at work. While the functional genetic information is capable of abstraction, it is also inextricably bound together with its chemical representation in such a way that a property right in the physical expression of the information is fundamentally connected to the information. A monopoly over the latter is a monopoly over the former, whereas a property right in isolated and purified adrenaline is not as intimately bound up with ownership of the abstract idea of adrenaline. Defenders of gene patents overstate the significance of isolation and purification. And this is why gene patents evoke such strong moral objections and also why functional genetic information is a product of nature, consistent with the doctrine expressed by the Supreme Court.

VI. Conclusion, Counterarguments, and Prospects for Reform

I have argued that gene patents encompassing functional genetic information are, when properly understood, excluded from patentability under the product of nature doctrine. In particular, I have argued that the product of nature doctrine is concerned with excluding subject matter with a broad scope and of a fundamentally essential nature both because of the economic consequences of patenting such subject matter and the broader implications to a democratic society. Defenders of gene patents have several responses to calls for reform, as do critics of gene patents who nevertheless caution moderation.

One common response is that, because the data indicating negative downstream economic effects is equivocal and the allegedly negative social consequences are intangible, at best policy makers should be wary of any significant changes to the patent laws concerning functional genetic

209. *See* Shulman, *supra* note 53, at 93–95 (arguing that the patent system's "toaster model of invention" is misapplied in the information age).

210. USPTO Utility Examination Guidelines, 66 Fed. Reg. 1092, 1093 (Jan. 5, 2001).

information.[211] This is a standard conservative argument that puts the burden of proof on those espousing change to justify meddling. A related argument is often expressed by analogy to the modern understanding of the Hippocratic Oath that commands, "first do no harm." Although current law is admittedly imperfect, the argument goes, in the absence of significant and demonstrable ongoing harm, we should err on the side of caution and not change thirty years of jurisprudence. Of course, the lurking assumption in that response is that the existing system is already justified. It is not enough that patents on functional genetic information (or any other field, for that matter) on balance do no economic harm. The Intellectual Property Clause of the Constitution bestows the power on Congress to grant monopoly rights to promote the "Progress of Science."[212] The burden to justify property rights is first and foremost on the parties arguing for them. Inconclusive data about the incentive effect of patents on innovation is at least as damaging to the argument in favor of property rights as it is a cautionary note for those advocating change. Overturning thirty years of patent protection is hardly worrisome if strong evidence exists that such protection was never truly necessary. While it is true that some reliance interests may be affected by a change, I have shown that there is evidence that other incentives for innovation exist that are particularly strong in the case of functional genetic information research. I have also shown that, far from being intangible, the social costs are both real and significant.

Another oft-raised response to criticisms of gene patents—particularly those raised on moral grounds—is that patent law is not the proper realm for issues of morality.[213] First, there is no requirement written into the statutory scheme that patentable inventions benefit humanity in any moral sense.[214] And with good reason, as the assumption is that technology is morally neutral. Furthermore, to the extent that technology may lead to immoral consequences, defenders of the system point out that a patent is not a right to use, only a right to exclude others.[215] To the extent that an invention is open

211. *See* Caulfield, *supra* note 6, at 145 ("[W]e do not have adequate evidence regarding the benefits of gene patents and the adverse implications of altering the existing system.").

212. U.S. CONST. art. I, § 8, cl. 8. The Supreme Court grants Congress great deference when it exercises the legislative authority conferred by the Intellectual Property Clause. *See, e.g.*, Eldred v. Ashcroft, 537 U.S. 186, 212 (2003) ("[I]t is generally for Congress, not the courts, to decide how best to pursue the [Intellectual Property Clause]'s objectives.").

213. *See, e.g.*, Benjamin D. Enerson, Note, *Protecting Society from Patently Offensive Inventions: The Risk of Reviving the Moral Utility Doctrine*, 89 CORNELL L. REV. 685, 718 (2004) (arguing that determinations regarding "the 'ethical "oughts"' . . . should occur in the legislature, where [moral and ethical] issues can receive wide attention and benefit from fruitful discussions among interested parties").

214. In the past, the courts dabbled with whether the utility requirement entailed a moral component but rejected the idea for a number of reasons, not the least of which is that courts felt ill equipped to judge morality. *Id.* at 690–91.

215. *See, e.g.*, Pilar N. Ossorio, *Property Rights and Human Bodies* (arguing that concerns about patent granting leading to "inappropriate application of marketplace values to human beings"

to immoral use, other areas of law may prohibit its use, but denial of a patent is an inappropriate and largely ineffective response.[216] However, this response conflates the immorality of *using* the patented invention with the immorality of granting a right to exclude. Such a response may be appropriate in responding to criticisms of granting patents on human clones or other higher-order life-forms, but it is misguided when offered as a response to arguments against functional genetic information patents. Those arguments are not that the subject matter itself is immoral but that the granting of a private right to exclude others is immoral.

A final criticism comes not from those who defend gene patents but from commentators who see a solution to the problem in existing patent doctrines. They argue that the subject-matter threshold is not the proper locus for excluding gene patents. Instead, they offer two other patentability requirements, nonobviousness and utility, as better candidates.[217] These arguments are attractive but ultimately not satisfying. Perhaps these requirements can be used to exclude particular patents, but two problems remain. First, such an approach is not in alignment with the moral arguments and provides no basis to connect those concerns to the doctrine. Second, both are too dependent on the state of the art and thus fail to provide a foundation for approaching the next wave of similarly objectionable patents, whatever unimaginable subject matter that might involve. A strengthened and reaffirmed product of nature doctrine can do this.

Despite the ruling in *Ass'n for Molecular Pathology v. U.S. Patent & Trademark Office*, opponents of gene patents have an uphill battle. The prevailing presumption that patent protection is necessary, the fervency with which biotechnology companies like Myriad defend their gene patents, and the thirty years of patent law affirming the patentability of genes tracing back to *Diamond v. Chakrabarty* all combine to present significant inertia. Neither the USPTO nor Congress appears close to enacting a change. The *Ass'n for Molecular Pathology* decision is a bright spot but now faces appeal. This Note has shown that the product of nature and isolation and purification doctrines have become disconnected from their underlying principles when applied to gene patents. When properly understood, the product of nature doctrine is not a descriptive group but an expression of normative concerns

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are misplaced because patents "convey only the right to exclude others from making, using, selling, or importing the patented item . . . [and] do not convey positive rights to possess, make, use, or sell anything"), *in* WHO OWNS LIFE?, *supra* note 24, at 223, 226.

216. *See* Wilson, *supra* note 141, at 38–39 (arguing that moral concerns are distinct from issues of patent law and that denying patents on organisms is unlikely to stop the spread of biotechnology).

217. *See, e.g.*, Bryan Nese, *Bilski on Biotech: The Potential for Limiting the Negative Impact of Gene Patents*, 46 CAL. W. L. REV. 137, 162, 165 (2009) (summarizing arguments for limiting gene patents using the utility and nonobviousness requirements); Ying Pan, *supra* note 161, at 306–07 (proposing new criteria for gene patentability based on the nonobviousness requirement); Mark Polyakov, *(Non)Obviousness of Claims to Genetic Sequences: Finding the Middle Ground*, 26 SANTA CLARA COMPUTER & HIGH TECH. L.J. 1, 31 (2010) (summarizing a proposed two-prong test for obviousness).

for hindrance, necessity, and democratic ideals. The isolation and purification doctrine is not an exception from these concerns but a refinement that helps identify subject matter that is not as likely to implicate them. Furthermore, functional genetic information has characteristics—essentialness, expression independence, and self-reference—that invoke the product of nature concerns while rendering the isolation and purification doctrine inapplicable. These conceptions can help combat the inertia of current law and lead to the recognition that, like the heat of the sun, genes are unpatentable products of nature.

—Jonah D. Jackson

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Reverse Erie and Texas Rule 202: The Federal Implications of Texas Pre-suit Discovery*

I. Introduction

In recent years, the U.S. Supreme Court has raised federal pleading standards for civil actions. Plaintiffs must now support their claims with factual content, and they must do so before they are entitled to discovery. Given that defendants often control critical information, plaintiffs face a catch-22: they need information to reach discovery, but they need discovery to access information.

Texas Rule of Civil Procedure 202 (Rule 202) can be used as a solution. Unlike analogous provisions of the Federal Rules of Civil Procedure, Rule 202 allows plaintiffs to conduct pre-suit depositions to investigate potential claims. For example, prior to filing a § 1983 claim, a plaintiff could first conduct Rule 202 pre-suit depositions to identify the correct defendants, ascertain the nature of the parties' involvement, and collect evidence of discriminatory intent. Armed with this factual content, the plaintiff could then file suit in federal or state court, and she would be better positioned to meet federal pleading standards.

Though several other states allow pre-suit discovery for limited purposes, only Texas grants broad pre-suit discovery for the investigation of potential claims. Because of this advantage, Rule 202 encourages forum shopping. Plaintiffs that would otherwise be unable to satisfy federal pleading standards due to a lack of information will be in a better position to do so solely because of their connection to Texas. If used in this fashion, Rule 202 undermines the uniformity of federal pleading standards.

Although Rule 202 presents a potentially significant advantage to plaintiffs in Texas, there are two main obstacles—one in federal court and the other in state court—that can prevent the application of Rule 202 to federal claims. First, in federal court, Rule 202 proceedings will likely be dismissed because the federal rules do not permit pre-suit discovery for the investigation of potential claims. Therefore, the removal of a Rule 202 proceeding will amount to a de facto dismissal. Second, in state court, Rule 202 might be preempted by the Reverse Erie doctrine. A petitioner must be able

* I would like to thank Professor Patrick Woolley for his invaluable guidance on this Note as well as Fleming Terrell and Professor Eden Harrington for their feedback on the initial drafts. I would also like to extend my gratitude to the staff and editorial board of the Texas Law Review, particularly Sarah Hunger and Tracey Bamberger, for all their work. Finally, I would like to thank Tracy and Naoki Ogishi for letting me crash their place while I worked on this Note and, of course, Maggie Waung for her encouragement and support throughout my time in law school.

to pass both obstacles (removal to federal court and preemption in state court) to use Rule 202 to investigate potential federal claims.

This Note proceeds in three Parts. Part II provides an overview of the scope of Rule 202 and its role in Texas courts. It discusses the goals of Rule 202, the mechanics of Rule 202 proceedings, and the role of pre-suit depositions in the federal system. Next, Part III examines the removability of Rule 202 proceedings and the obstacles that federal courts present to the application of Rule 202 to potential federal claims. Removal will not be possible for the vast majority of Rule 202 petitions. Because neither federal-question jurisdiction nor diversity jurisdiction will be proper for Rule 202 proceedings, removal will depend on alternative statutory grants of federal jurisdiction. These grants are far more limited—they typically address specific issues, such as antitrust, patents, or certain congressionally chartered organizations. But there is one type of case where removal will generally be proper: petitions seeking to depose federal officials acting under color of office will be removable under the federal officer-removal statute, § 1442.

Finally, Part IV assesses whether Rule 202 will be preempted in state court. Even though most Rule 202 proceedings will generally not be removable, they might still be preempted through the Reverse Erie doctrine.[1] Reverse Erie is a federal common law doctrine that applies when state courts adjudicate federal claims. It governs whether federal or state procedure applies in such instances. This Note contends that Reverse Erie will generally not preempt Rule 202 but that preemption may still arise if Rule 202 petitions explicitly rely on federal claims to justify the burdens of pre-suit depositions.

II. Pre-suit Discovery

While the federal courts and most state courts allow for some pre-suit discovery, only Texas grants broad power to investigate potential claims.[2] Most states limit pre-suit discovery to the preservation of witness testimony, which only applies when witnesses might become unavailable (e.g., by dying or leaving the jurisdiction).[3] Several jurisdictions allow pre-suit discovery when the plaintiff already has a claim and merely needs to determine the

1. Academics have used different terms when referring to this doctrine (e.g., "reverse Erie" or "Converse Erie"). This Note will refer to the doctrine as "Reverse Erie."

2. *See* Lonny Sheinkopf Hoffman, *Access to Information, Access to Justice: The Role of Presuit Investigatory Discovery*, 40 U. MICH. J.L. REFORM 217, 240–42 (2007) (asserting that only Alabama and Texas allow for pre-suit depositions to investigate potential claims and describing the limitations of Alabama's rule—both in theory and in practice—relative to Texas's broad grant of pre-suit discovery).

3. *See id.* at 225, 235 (discussing typical pre-suit discovery mechanisms, which are limited to the preservation of witness testimony, and asserting that most states mirror the cramped federal pre-suit discovery rules).

proper party to sue.[4] Much broader in scope, Rule 202 does not require the potential plaintiff to have a well-defined claim; it allows pre-suit depositions even when the potential claims are highly speculative.[5] In addition, Rule 202 is not restricted to potentially liable defendants; it allows depositions of third-party witnesses.

This Note focuses on the application of Rule 202 to federal causes of action. One Texas court has faced this issue but managed to sidestep the larger questions of federal preemption. In *City of Houston v. U.S. Filter Wastewater Group, Inc.*,[6] a petitioner sought to depose City of Houston employees, but because governmental immunity barred most claims, the petitioner's only potential claim against the city (patent infringement) was exclusively federal.[7] The court circumvented the issue by identifying a potential state claim (civil conspiracy) between the petitioner and another corporation and allowed the depositions of the city employees as third parties to that claim.[8] The court did not rule on whether state courts could order Rule 202 depositions based on potential federal claims.[9] This Note seeks to answer that question.

A. The Scope of Rule 202

In 1999, the Texas Supreme Court created Rule 202 by combining two previous pre-suit procedures. The 1999 amendments combined former Texas Rule of Civil Procedure 737 (the equitable bill of discovery) and former Texas Rule of Civil Procedure 187 (the deposition to perpetuate testimony).[10] Of the two, Rule 737 was broader in scope: it allowed for the investigation of potential claims. Rule 187, on the other hand, only allowed pre-suit

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4. *See id.* at 225–26 (asserting that while several jurisdictions permit pre-suit discovery to confirm the proper party to sue, these forums "disallow discovery for the broader investigatory purpose of determining whether a cause of action exists").

5. *See infra* notes 18–24 and accompanying text.

6. 190 S.W.3d 242, 245 (Tex. App.—Houston [1st Dist.] 2006, no pet.).

7. *See id.* at 245 (discussing the City's contention that it was "immune from any state law claims and that the only potentially actionable claim against it" was an exclusive federal patent infringement claim). Although the parties did not raise the issue, it is possible that Rule 202 hearings do not consider affirmative defenses. *See infra* notes 29–33 and accompanying text. The court in *City of Houston* did not decide whether qualified immunity—or other affirmative defenses—could make all suits so infeasible that no potential claims could reasonably exist.

8. *City of Houston*, 190 S.W.3d at 245. U.S. Filter justified the depositions by claiming that the City of Houston employees were the most knowledgeable individuals about facts relevant to the potential claim against Altivia. *Id.* at 244.

9. *See id.* at 245 (mentioning the City's argument that the state court lacked jurisdiction over the petitioner's federal claims but deciding the case on other grounds).

10. *See* NATHAN L. HECHT & ROBERT H. PEMBERTON, A GUIDE TO THE 1999 TEXAS DISCOVERY RULES REVISIONS, at G17 (1998), *available at* http://www.supreme.courts.state.tx.us/rules/tdr/disccle37.pdf (explaining the process by which Rule 202 was drafted); *see also* Roger W. Hughes, *Appealing a Deposition Order Under Tex. R. Civ. P. 202*, APP. ADVOC., Spring 2001, at 10, 10 (discussing the purpose of Rule 202).

depositions for anticipated suits.[11] But Rule 737 lacked several of the procedural safeguards of Rule 187, such as notice requirements.[12] In drafting Rule 202, the Texas Supreme Court retained the broad scope of Rule 737 by permitting pre-suit depositions either in anticipation of suit or to investigate potential claims, but the court also incorporated the notice provisions of Rule 187 as a safeguard against abuses like those that occurred under old Rule 737.[13]

Rule 202 proceedings begin with a petition, which must state that the petitioner either anticipates a suit or seeks to investigate a potential claim.[14] This Note focuses on petitions to investigate potential claims, as opposed to those in anticipation of a suit.[15] Petitions to investigate potential claims must give, among other things, a reason for each witness's testimony and the expected substance of the testimony.[16] In deciding whether to grant a petition, the court applies a balancing test: it asks whether "the likely benefit of allowing the petitioner to take the requested deposition . . . outweighs the burden or expense of the procedure."[17]

In practice, courts have granted petitions almost as a matter of course.[18] Even speculative claims will outweigh the typical burdens (e.g., time and cost) of allowing depositions. In fact, the Texas Courts of Appeals have consistently held that the petition does not need to explicitly state a viable claim[19] because the express purpose of Rule 202 is to allow potential litigants

11. Hoffman, *supra* note 2, at 242. The State Bar's Court Rules Committee recommended the repeal of Rule 737. *Id.* at 243. Plaintiffs' groups countered that robust pre-suit discovery reduced frivolous lawsuits by enabling plaintiffs to determine the merits of potential claims without having to file suit. *Id.* at 244.

12. *See id.* at 242 (contrasting Rules 187 and 737 and noting the absence of a fifteen-day notice requirement in Rule 737).

13. *Id.* at 245.

14. TEX. R. CIV. P. 202.2.

15. Unless otherwise specified, subsequent discussions of Rule 202 should be interpreted to mean petitions to investigate potential claims as opposed to depositions for the preservation of testimony.

16. TEX. R. CIV. P. 202.2(g).

17. *Id.* R. 202.4(a)(2). The balancing test applies only to investigations of potential claims. Anticipated suits have their own test. *Id.* R. 202.4(a)(1).

18. *See* Hoffman, *supra* note 2, at 258 (describing large-scale, though nonscientific, survey results that indicated that 60%–70% of Rule 202 petitions are granted); Hughes, *supra* note 10, at 10 ("Courts in some parts of the state grant Rule 202 petitions as a matter of course so long as the evidence sought is not privileged.").

19. *See, e.g.*, *In re* Emergency Consultants, Inc. 292 S.W.3d 78, 79 (Tex. App.—Houston [14th Dist.] 2007, no pet.) ("Rule 202 does not require a potential litigant to expressly state a viable claim before being permitted to take a pre-suit deposition."); *In re* Allan, 191 S.W.3d 483, 488 (Tex. App.—Tyler 2006, no pet.) (holding that Rule 202 petitions are appropriate prior to the filing of a health care liability claim and despite a stay of discovery), *mand. conditionally granted*, *In re* Jorden, 249 S.W.3d 416 (Tex. 2008).

to discover whether they have a cause of action at all.[20] For example, in *In re Emergency Consultants, Inc.*[21] the court allowed a doctor to conduct pre-suit depositions even though the doctor's petition did not identify any viable claims.[22] Specifically, the court held that "a potential litigant should be permitted to explore whether claims exist without having to file a lawsuit to do so."[23] The court reasoned that a contrary holding would "eviscerate the investigatory purpose of Rule 202 and essentially require one to file suit before determining whether a claim exists."[24]

There are special considerations, however, that considerably increase the burdens of allowing Rule 202 depositions.[25] For instance, after a team of employees resigned from Dell and joined Hewlett Packard (HP), Dell filed a Rule 202 petition to depose its former employees.[26] Given that the depositions might have required the disclosure of trade secrets, thereby causing "grave and irreparable harm" to HP,[27] the court held that the substantial burdens of granting the depositions outweighed the likely benefits.[28]

Additionally, some Texas courts have held that courts should not address affirmative defenses during pre-suit discovery proceedings. For instance, in *Parker v. Lindsey*,[29] the plaintiff claimed that she was the true creator of the toy dinosaur Barney, and her petition pointed to potential claims over the misappropriation of trade secrets and conversion.[30] Although her claims might have been preempted by federal copyright law and barred by the statute of limitations, the court held that the petitioner was not required to conclusively negate potential affirmative defenses—all that was

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20. *See Emergency Consultants*, 292 S.W.3d at 79 (discussing how a potential litigant should, under Rule 202, be permitted to explore whether claims exist without having to file suit).

21. *Id.* at 78.

22. The doctor's best claim would have involved a violation of the Texas Medical Practice Act, but unfortunately the Act did not provide a private cause of action. Instead, the court allowed the depositions based on the nebulous possibility of a potential contract claim. *See id.* at 79 (upholding the district court's order permitting several depositions despite the lack of specifically identifiable claims).

23. *Id.*

24. *Id.*

25. For example, trade secrets pose a substantial burden because they receive heightened protection during discovery. *In re* Hewlett Packard, 212 S.W.3d 356, 362 (Tex. App.—Austin 2006, no pet.).

26. *Id.* at 359–60.

27. *Id.* at 361. Dell did not dispute this claim. *Id.* at 362.

28. *Id.*

29. No. 05-98-01249-CV, 1999 WL 446067 (Tex. App.—Dallas June 2, 1999, pet. denied) (not designated for publication).

30. *Id.* at *1. This case bridges the 1999 amendments to the Texas Rules of Civil Procedure. The plaintiff first filed a petition for bill of discovery when former Rule 737 was still in effect, but the Court of Appeals reviewed the decision after Rule 202 had replaced Rule 737. *See id.* at *1 n.1 (specifying that the court would apply Rule 737 to the case because Rule 202 only applies to discovery requests filed on or after January 1, 1999).

required was a reasonable basis for believing that a cause of action existed.[31] The court reasoned that pre-suit proceedings could not address affirmative defenses without leading to a full-blown trial on the merits.[32] Furthermore, if the court ruled on the applicability of future defenses that might be asserted, the court would create an impermissible advisory opinion on the merits of those defenses.[33]

B. Federal Pre-suit Discovery

Unlike Texas, the Federal Rules of Civil Procedure do not allow pre-suit discovery for the investigation of potential claims.[34] Federal Rule 27, the primary pre-suit discovery mechanism, only allows pre-suit depositions for the preservation of testimony and requires that the petitioner unequivocally state that he expects to be a party to an action.[35] Thus, Federal Rule 27 resembles former Texas Rule 187—both authorize pre-suit depositions solely for the preservation of testimony in anticipated suits.[36]

Because federal courts have limited mechanisms for pre-suit discovery, federal pleading standards play a critical role in restricting access to discovery. Federal pleading standards have grown more stringent in recent years. *Bell Atlantic Corp. v. Twombly*[37] replaced the traditionally lenient "no set of facts" standard with a stricter "flexible plausibility" standard.[38] Under *Twombly*, plaintiffs must plead enough factual content to allow the

31. *Id.* at *3.

32. *Id.* at *3 n.8.

33. *Id.*

34. *See* Hoffman, *supra* note 2, at 227 (stating that the established interpretation of the Federal Rules of Civil Procedure does not allow broad pre-suit discovery).

35. FED. R. CIV. P. 27(a)(1).

36. Federal courts might theoretically retain an equitable bill of discovery, a holdover from before the merger of law and equity that stems from an inherent equitable power of federal courts to authorize broad discovery. *See* Hoffman, *supra* note 2, at 232–33 (indicating that Federal Rule 27(c) permits independent actions in the nature of an equitable bill of discovery). In fact, former Texas Rule 737—which explicitly allowed for the investigation of potential claims—codified a similar, preexisting equitable procedure in Texas. *See id.* at 242 (explaining that although former Rule 737 did not include explicit language allowing for the investigation of potential claims, Texas courts interpreted it to include this power based upon equitable principles). The federal equitable bill of discovery, however, has become disfavored. It arguably was disfavored after the 1938 introduction of the Federal Rules of Civil Procedure. *See id.* at 228–29 (noting that several scholars commented disapprovingly of a pre-suit bill of discovery during the Advisory Committee meetings leading up to the 1938 Federal Rules of Civil Procedure). It was explicitly disfavored after the 1991 amendments to the Federal Rules, in which the Advisory Committee Notes "suggest that there is almost no need for a court to invoke an inherent power outside of the Federal Rules to authorize an equitable discovery action." *Id.* at 234.

37. 550 U.S. 544 (2007).

38. *Id.* at 560–61.

reasonable inference that the defendant is liable for the alleged misconduct.[39] Essentially, the plaintiff must amplify a claim with factual allegations.

To collect the necessary facts, plaintiffs traditionally relied on discovery. In 2009, however, *Ashcroft v. Iqbal*[40] held that plaintiffs must pass the flexible plausibility standard *before* they are entitled to discovery.[41] Thus, after *Twombly* and *Iqbal*, plaintiffs must support their claims with specific factual allegations in order to reach discovery, even though discovery is often essential to unearthing the relevant facts. With *Iqbal*, the Supreme Court has created a procedural catch-22 that restricts access to federal courts. In Texas, Rule 202 can mitigate the severity of the federal pleading standards by providing access to pre-suit depositions. Rule 202 could give a potential plaintiff the opportunity to flesh out his claims with specific facts before having to file a complaint or face a motion to dismiss for failure to state a claim.

III. Rule 202 in Federal Courts

On occasion, defendants attempt to remove Rule 202 proceedings to federal court. Given that federal pre-suit discovery does not allow for the investigation of potential claims, these proceedings would likely be dismissed without prejudice.[42] Thus, the removal of Rule 202 petitions essentially amounts to a de facto dismissal.

This Part analyzes the different bases for removing Rule 202 proceedings to federal court. Although federal courts have consistently remanded Rule 202 proceedings to state courts, they have done so for different reasons. Because federal-question and diversity jurisdiction will not be proper, the vast majority of Rule 202 proceedings correctly remain in Texas courts. Removal should be allowed, however, in the limited circumstances where other statutes grant original jurisdiction to federal courts. This suggestion is controversial. Some might argue that Rule 202 proceedings are not removable even when other statutes grant original jurisdiction to federal

39. *See id.* at 555 ("Factual allegations must be enough to raise a right to relief above the speculative level . . . on the assumption that all the allegations in the complaint are true . . . ." (citations omitted)); *see also* Ashcroft v. Iqbal, 129 S. Ct. 1937, 1949 (2009) ("A claim has facial plausibility when the plaintiff pleads factual content that allows the court to draw the reasonable inference that the defendant is liable for the misconduct alleged.").

40. 129 S. Ct. 1937 (2009).

41. *See id.* at 1954 ("Because respondent's complaint is deficient under Rule 8, he is not entitled to discovery . . . .").

42. Although federal law typically governs procedural matters in federal courts, it remains unclear whether federal or state procedure would apply to Rule 202 proceedings after removal. The procedural nature of Rule 202, however, would likely result in federal procedure applying. *See In re* Enable Commerce, Inc., 256 F.R.D. 527, 531–32 (N.D. Tex. 2009) (asserting that while "the law to be applied after removal is unclear," Rule 202 is by nature procedural and thus likely requires the application of federal law).

courts because Rule 202 proceedings are not "civil actions."[43] In fact, district courts have split on whether Rule 202 proceedings are civil actions within the meaning of § 1441. This Note contends that they are and argues that as such, Rule 202 proceedings should be removable when there is a statutory grant of federal jurisdiction. In addition, irrespective of whether they are considered removable under § 1441, Rule 202 proceedings against federal officials should be removable under the federal officer removal statute, § 1442, for activities conducted under color of office.

A. Subject-Matter Jurisdiction

Because a Rule 202 petition does not assert any claims and may never lead to a lawsuit, federal courts have difficulty determining with any certainty whether federal-question or diversity jurisdiction is proper.[44] As courts of limited jurisdiction, federal courts resolve doubts regarding federal jurisdiction with a presumption against removal.[45] Accordingly, many district courts have held that subject-matter jurisdiction is not proper for Rule 202 proceedings.[46]

1. Diversity Jurisdiction.—There are two main sources for subject matter jurisdiction: federal-question and diversity jurisdiction. Diversity jurisdiction will never be proper for Rule 202 proceedings. Under § 1332, the diversity statute, both parties must be completely diverse, and the amount in controversy must be greater than $75,000.[47] In Rule 202 proceedings, however, the amount in controversy will be difficult to determine because Rule 202 does not require the petitioner to allege specific claims or damages.[48] Thus, the scope of future litigation—if suit is filed at all—will be unclear at the time of the Rule 202 hearing.[49]

For example, in *In re Enable Commerce, Inc.*,[50] the defendant sought to remove the Rule 202 proceeding based on diversity of citizenship, citing the transactions between the parties (valued at $200,000 that year) and the total size of the business that would be subject to the potential action (valued at

43. *See infra* notes 73–76 and accompanying text.

44. *Id.* at 531.

45. Kokkonen v. Guardian Life Ins. Co., 511 U.S. 375, 377 (1994).

46. *See, e.g.*, *Enable Commerce*, 256 F.R.D. at 533 (finding lack of diversity jurisdiction); Page v. Liberty Life Assurance Co. of Bos., No. 4:06-CV-572-A, 2006 WL 2828820, at *5 (N.D. Tex. Oct. 3, 2006) (remanding the case for lack of subject-matter jurisdiction); Mayfield-George v. Tex. Rehab. Comm'n, 197 F.R.D. 280, 283–84 (N.D. Tex. 2000) (finding lack of federal-question jurisdiction).

47. 28 U.S.C. § 1332(a) (2006).

48. *Enable Commerce*, 256 F.R.D. at 532.

49. *Id.*

50. 256 F.R.D. 527 (N.D. Tex. 2009).

$12 million annually).[51] But because the petitioner sought the pre-suit depositions to determine whether to pursue any claims at all, the size and scope of future litigation was unclear.[52] As a result, the court held that the defendant had failed to establish the value of the amount in controversy.[53] The speculative nature of the Rule 202 petition prevented accurate monetary valuation, and the court held that doubts over removal should be resolved against federal jurisdiction.[54]

It is important to note that all diversity cases require some amount of speculation over the amount in controversy. In typical diversity cases, the amount claimed by the plaintiff will control unless the claim was not made in good faith, or it appears "to a legal certainty that the claim is really for less than the jurisdictional amount."[55] This rule should not apply to Rule 202 where the defendant—as opposed to the plaintiff—estimates the amount in controversy, thus adding an additional layer of speculation. In the normal diversity scenario, there is only one layer of speculation: the plaintiff estimates the value of her claim. If she acts in good faith, it is plausible she could recover that amount. In the Rule 202 scenario, the defendant must speculate as to what claims the plaintiff might bring, as well as to the value of those claims. Even if the defendant acts in good faith, she cannot reliably predict which claims, if any, the potential plaintiff may bring.

2. Federal-Question Jurisdiction.—Likewise, federal-question jurisdiction will not be proper for Rule 202 proceedings. Under § 1331, the federal-question statute, federal courts have original jurisdiction over "all civil actions arising under the Constitution, laws, or treaties of the United States."[56] The Supreme Court has long interpreted § 1331 as requiring a federal question to appear on the face of a well-pleaded complaint,[57] and federal district courts have applied the well-pleaded-complaint rule to Rule 202 petitions.[58] But even when they are based on potential federal claims, Rule 202 petitions will not satisfy the well-pleaded-complaint rule.[59] Rule 202

51. *Id.* at 532.

52. *Id.*

53. *Id.* at 533.

54. *Id.* at 532–33 (quoting Acuna v. Brown & Root Inc., 200 F.3d 335, 339 (5th Cir. 2000)).

55. St. Paul Mercury Indem. Co. v. Red Cab Co., 303 U.S. 283, 288–89 (1938) (citations omitted).

56. 28 U.S.C. § 1331 (2006).

57. *See generally* Louisville & Nashville R.R. Co. v. Mottley, 211 U.S. 149 (1908) (establishing the well-pleaded-complaint rule, which requires that the federal question arise from the pleadings rather than from potential defenses).

58. *See, e.g.*, Mayfield-George v. Tex. Rehab. Comm'n, 197 F.R.D. 280, 283 (N.D. Tex. 2000) (asking whether the Rule 202 petition contains a claim or right arising from the Constitution).

59. *See id.* (describing the respondent's contention that a petition based on potential federal claims can be removed and calling the contention baseless).

petitions contain *potential*, as opposed to *actual*, claims.[60] Therefore, actual federal claims will never appear on the face of a well-pleaded Rule 202 petition.

Furthermore, even if potential claims could justify federal-question jurisdiction, federal law would not be incorporated into the state cause of action (i.e., Rule 202) simply because the petition mentions federal claims. Though the existence of potential federal claims may help justify the benefits of allowing pre-suit depositions, the outcome of Rule 202 proceedings will not be determined by applying or resolving issues of federal law. Rule 202 proceedings will be decided purely by the application of Texas procedure; they will not depend on the merits of any potential claims or on the bodies of law from which the potential claims might arise. The court need not adjudicate any aspect of federal law to decide the outcome of a Rule 202 proceeding. Therefore, federal issues are only tangentially related, and petitions to investigate potential federal claims will not arise under federal law.

Similarly, the nebulous nature of potential claims will undermine attempts to establish subject-matter jurisdiction through the complete-preemption doctrine. The complete-preemption doctrine can grant subject-matter jurisdiction but only in "extraordinary circumstances when Congress intended not only to preempt the state law . . . , but to replace it with a federal law."[61] In *Page v. Liberty Life Assurance Co. of Boston*,[62] the petitioner sought to depose employees of Liberty Life Assurance Company under Rule 202.[63] Liberty removed the proceedings to federal court, claiming that the potential state claim would be completely preempted by the Employee Retirement Income Security Act (ERISA).[64] The federal district court remanded the case, holding that it was not required to consider "preemption issues that might arise in a later action."[65] The court's reasoning resembles the approach that some Texas courts have taken with respect to affirmative defenses in Rule 202 hearings. Because such inquiries might lead to impermissible advisory opinions and full-blown trials on the merits of those defenses, some Texas courts have refused to address affirmative defenses in Rule 202 proceedings.[66] The same concerns apply when federal courts consider preemption issues that may or may not arise in a later action. Therefore, the *Page* court was correct in holding that the complete-

60. *Id.*

61. Page v. Liberty Life Assurance Co. of Bos., No. 4:06-CV-572-A, 2006 WL 2828820, at *4 (N.D. Tex. Oct. 3, 2006).

62. *Id.*

63. *Id.* at *1.

64. *Id.*

65. *Id.*

66. *See supra* notes 29–33 and accompanying text.

preemption doctrine should not be a basis for the removal of Rule 202 proceedings.

B. Removal Under § 1441

As has been shown, federal courts typically will not have subject-matter jurisdiction over Rule 202 proceedings because federal-question and diversity jurisdiction will not be proper. Removal could still be possible, however, when other statutes grant original jurisdiction to the federal courts. Section 1441 allows for removal of civil actions when federal district courts have original jurisdiction over the action.[67] Several statutes could potentially provide this basis for removing Rule 202 proceedings, such as those regarding patents, antitrust, or suits involving national banks.[68]

But even if a statute grants federal jurisdiction, Rule 202 proceedings will not be removable unless they are considered civil actions.[69] The definition of a civil action varies among statutes, and in certain instances, two different definitions may need to be satisfied. To begin, all Rule 202 proceedings must meet the definition as outlined in § 1441. For petitions that involve congressionally chartered organizations, this first requirement alone is sufficient. Otherwise, Rule 202 proceedings must also be considered civil actions under the various statutes granting jurisdiction, e.g., § 1333 or § 1337. This Note will focus on the definition of civil actions under § 1441 because that definition applies to all Rule 202 proceedings. The definitions of a civil action for other, more specific jurisdictional statutes are beyond the scope of this Note.

District courts have split on whether Rule 202 proceedings are civil actions under § 1441. In the year after Rule 202 was created, three federal district courts examined whether Rule 202 proceedings were removable. In *In re Texas*,[70] the court held Rule 202 proceedings to be removable civil

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67. 28 U.S.C. § 1441 (2006).

68. Several statutes in Title 28 grant original jurisdiction for certain types of cases, such as admiralty, antitrust, or intellectual property. *See id.* § 1333 ("The district courts shall have original jurisdiction, exclusive of the courts of the States, of: (1) Any civil case of admiralty or maritime jurisdiction . . . ."); § 1337(a) ("The district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies . . . ."); § 1338 ("The district courts shall have original jurisdiction of any civil action arising under any Act of Congress relating to patents, plant variety protection, copyrights and trademarks."). In addition, federal jurisdiction will exist for suits that involve certain congressionally chartered organizations, such as national banks or the Red Cross. *See, e.g.*, Am. Red Cross v. S.G., 505 U.S. 247, 255–57 (1992) (holding that congressional charters provide separate and independent grants of federal jurisdiction if their "sue or be sued" provisions specifically mention federal courts).

69. *See* 28 U.S.C. § 1441(a) (2006) ("[A]ny civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed . . . .").

70. 110 F. Supp. 2d 514 (E.D. Tex. 2000), *rev'd on other grounds sub nom.* Texas v. Real Parties in Interest, 259 F.3d 387 (5th Cir. 2001).

actions.[71] Conversely, in *Mayfield-George v. Texas Rehabilitation Commission*[72] and *McCrary v. Kansas City Southern Railroad*,[73] the courts held that Rule 202 proceedings were not civil actions under § 1441 and were therefore categorically unremovable.[74] Subsequently, district courts have split, with some citing *In re Texas* for the proposition that Rule 202 proceedings are removable civil actions,[75] and the majority of courts citing *Mayfield-George* and *McCrary* for the opposite conclusion.[76] The Fifth Circuit specifically declined to determine the issue in *Texas v. Real Parties in Interest*.[77]

The *Mayfield-George* and *McCrary* courts held that a civil action within the meaning of § 1441 must assert a cause of action.[78] Rule 202 petitions merely request pre-suit depositions; they do not set forth any claims for relief and thus are not civil actions.[79] In addition, the *McCrary* court considered the § 1441 definition of civil action in the context of § 1446. As the court pointed out, "section 1446(b) details the procedures of removal and states that 'the notice of removal . . . shall be filed within thirty (30) days after the receipt . . . of a copy of the initial pleading *setting forth the claim for relief upon which such action or proceeding is based.*'"[80] Because Rule 202 proceedings do not have pleadings or set forth actual claims, they do not constitute civil actions within the meaning of either § 1441 or § 1446.[81]

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71. *Id.* at 521–22.

72. 197 F.R.D. 280 (N.D. Tex. 2000).

73. 121 F. Supp. 2d 566 (E.D. Tex. 2000).

74. *See Mayfield-George*, 197 F.R.D. at 283 (holding that Rule 202 petitions do not assert claims and therefore are not civil actions); *McCrary*, 121 F. Supp. 2d at 569 (holding that Rule 202 proceedings are not civil actions within the meaning of § 1441).

75. *See, e.g.*, Page v. Liberty Life Assurance Co. of Bos., No. 4:06-CV-572-A, 2006 WL 2828820, at *3 (N.D. Tex. Oct. 3, 2006) (citing *In re Texas*, 110 F. Supp. 2d at 514) (holding that a Rule 202 proceeding had all of the elements of a civil action and thus would be treated as such).

76. *See In re* Enable Commerce, Inc., 256 F.R.D. 527, 530 (N.D. Tex. 2009) ("The majority of Texas courts that have considered whether a Rule 202 proceeding is removable have held that it is not."); *see also, e.g.*, Sawyer v. E.I. Du Pont de Nemours, No. Civ.A. 06-1420, 2006 WL 1804614, at *2 (S.D. Tex. June 28, 2006) (finding *Mayfield-George* and *McCrary* persuasive); Davidson v. S. Farm Bureau Cas. Ins. Co., No. H-05-03607, 2006 WL 1716075, at *2 (S.D. Tex. June 19, 2006) (citing *Mayfield-George* and *McCrary*); *cf.* Waller v. Wal-Mart Stores, Inc., No. 4:01-CV-629-Y, 2002 U.S. Dist. LEXIS 3586, at *1 & n.1 (N.D. Tex. Mar. 4, 2002) (discussing the positions of *Mayfield-George*, *McCrary*, and *In re Texas* but ultimately avoiding the issue by holding that subject-matter jurisdiction was not proper).

77. 259 F.3d 387, 395 (5th Cir. 2001).

78. *See Mayfield-George*, 197 F.R.D. at 283 ("First, the Petition is not a 'civil action' under § 1441(b) because it asserts no claim or cause of action upon which relief can be granted."); *McCrary*, 121 F. Supp. 2d at 569 ("First, a Rule 202 Request is not a civil action within the meaning of § 1441 because it asserts no claim or cause of action upon which relief can be granted.").

79. *McCrary*, 121 F. Supp. 2d at 569.

80. *Id.* (quoting 28 U.S.C. § 1446(b)).

81. *Id.*

Conversely, the court in *In re Texas* held that Rule 202 proceedings were civil actions.[82] The court traced the historical scope of federal removal statutes, which before 1948 used the term *suit* instead of civil action, and emphasized the broad definition of *suit* in each iteration of the statute.[83] Originally, Chief Justice Marshall interpreted the term, as used in the Judiciary Act of 1789, to cover "any proceeding in a court of justice, by which an individual pursues [a] remedy."[84] After the 1875 reenactment of the removal statute, the Supreme Court interpreted suit to mean "a dispute between litigants before a tribunal that has the power to determine questions of law and fact."[85] When the Supreme Court interpreted the 1911 revision of the removal statute, the Court listed the elements of removable proceedings.[86] The *In re Texas* court adopted this definition and concluded that Rule 202 satisfied each element.[87] Rule 202 proceedings involve "a controversy between parties; there are pleadings (the [Rule 202] petition); relief is sought (. . . a court order authorizing the taking of depositions); . . . a judicial determination is required" (the court must weigh the benefits of allowing the depositions against the likely burdens of the procedure); and the decision results in an enforceable, appealable order.[88] Unlike *Mayfield-George*, which focused on a single criterion in isolation—the assertion of a cause of action—the *In re Texas* court insisted on examining the proceeding as a whole.[89]

Although a majority of cases have relied on *Mayfield-George* and *McCrary* to conclude that Rule 202 proceedings are not civil actions, this Note contends that *In re Texas* presents a more thorough and historically

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82. 110 F. Supp. 2d 514, 521–22 (E.D. Tex. 2000), *rev'd on other grounds sub nom.* Texas v. Real Parties in Interest, 259 F.3d 387 (5th Cir. 2001).

83. *See id.* at 519–20 (chronicling the history of removal provisions and statutes, starting with the Judiciary Act of 1789, to demonstrate how terms used to describe removal proceedings have been construed increasingly broadly).

84. *Id.* at 519 (quoting Weston v. City Council of Charleston, 27 U.S. (2 Pet.) 449 (1829)).

85. *Id.* (citing Upshur Cnty. v. Rich, 135 U.S. 467, 477 (1890)).

86. *Id.* at 520. According to the Court,

> a removable proceeding is one in which there are one or more of the following: a dispute between parties; a prayer for relief (either at law or in equity); pleadings; a tribunal with the power to determine questions of law and fact; the determination of the tribunal is subject to review; and enforceable orders.

Id.

87. *Id.* at 521–22.

88. *Id.* The Texas Supreme Court has yet to rule on whether Rule 202 decisions are appealable. Its cases on pre-suit discovery appeals all predate Rule 202 and are based on the distinction between the equitable bill of discovery (former Rule 737) and depositions to perpetuate testimony (former Rule 187). For a discussion of how petitions to depose opposing parties in anticipated suits—which would have fallen under former Rule 187—are ancillary to the anticipated suit and thus not appealable, while investigations of potential claims—which would have fallen under former Rule 737—are independent, appealable actions, see Hughes, *supra* note 12.

89. *In re Texas*, 110 F. Supp. 2d at 522.

accurate definition. The *In re Texas* analysis is supported by the Supreme Court's interpretation of prior removal statutes. Conversely, the only authorities cited by *Mayfield-George* and *McCrary* are district court decisions from other states.[90] Furthermore, the holding in *Mayfield-George* may have been based predominately on a lack of federal-question jurisdiction under § 1331 as opposed to the definition of a civil action under § 1441.[91]

In re Texas also challenged *McCrary*'s conclusion that § 1446 implies a narrow interpretation for § 1441. Section 1446 creates a thirty-day window for removal after the "initial pleading setting forth the claim for relief."[92] *McCrary* reasoned that, because Rule 202 petitions do not state claims, Rule 202 petitions are not removable. The interplay between § 1441 and § 1446, however, could be interpreted another way. Supporters of *McCrary* can point to a Fifth Circuit decision that held an equitable bill of discovery (the predecessor to Rule 202) was not an "initial pleading" and thus did not trigger the § 1446 removal window.[93] Nevertheless, a petition may be a removable civil action under § 1441 even if it does not trigger the removal window of § 1446. As explained in *In re Texas*, § 1446 merely defines procedures relating to removal; it does not define what kind of proceedings are removable—that is the purpose of § 1441.[94] Because *In re Texas* provides the most thorough and historically accurate understanding of § 1441, Rule 202 proceedings should be considered civil actions under § 1441. They should thus be removable in the limited circumstances where original jurisdiction is proper through means other than federal-question or diversity jurisdiction.

C. The Federal Officer Removal Statute

In addition to the limited circumstances of removal under jurisdiction-granting statutes, a defendant can also potentially remove a Rule 202 proceeding to federal court under § 1442. Section 1442 allows for the removal of civil actions against federal officers or agencies for activities carried out under color of office. Provided these conditions are met, Rule 202 petitions against federal officers will be removable if Rule 202 proceedings are considered civil actions under § 1442. Recently, a federal district court held

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90. *See* Mayfield-George v. Tex. Rehab. Comm'n, 197 F.R.D. 280, 283 (N.D. Tex. 2000) (citing *In re* HiNote, 179 F.R.D. 335, 336 (S.D. Ala. 1998), and Sunbeam Television Corp. v. Columbia Broad. Sys., Inc., 694 F. Supp. 889, 891 (S.D. Fla. 1988)); McCrary v. Kansas City S. R.R., 121 F. Supp. 2d 566, 569 (E.D. Tex. 2000) (citing *Mayfield-George*, 197 F.R.D. at 283).

91. *See Mayfield-George*, 197 F.R.D. at 283 (stressing that even if it can be argued that the petition is a civil action, "it surely is not removable under § 1441(b) because it is not a 'civil action of which federal district courts have *original jurisdiction* founded on a claim or right arising under the Constitution, treaties or laws of the United States.'").

92. 28 U.S.C. § 1446(b) (2006).

93. Wilson v. Belin, 20 F.3d 644, 651 n.8 (5th Cir. 1994).

94. *In re Texas*, 110 F. Supp. 2d at 523.

that, because they do not assert claims, Rule 202 petitions are not civil actions.[95] This Note contends, however, that removal under § 1442 should value substance over form, and it should not hinge on a technical definition of a civil action.

The purpose of § 1442 has been clearly established: it prevents hostile state courts from interfering with the legitimate exercise of federal authority.[96] Section 1442 protects an important federal interest in the "enforcement of federal law through federal officials" by providing a federal forum where federal officers can raise defenses arising from their official duties.[97] According to the Supreme Court,

> The federal officer removal statute is not "narrow" or "limited." . . . At the very least, it is broad enough to cover all cases where federal officers can raise a colorable defense arising out of their duty to enforce federal law . . . . Congress has decided that federal officers, and indeed the Federal Government itself, require the protection of a federal forum. This policy should not be frustrated by a narrow, grudging interpretation of § 1442(a)(1).[98]

Therefore § 1442 should be given "a sufficiently broad reading so as not to frustrate its underlying rationale."[99] In other words, § 1442 should look to the substance rather than the form of the state proceeding and should allow removal when state proceedings interfere with the exercise of federal authority.

When Rule 202 is used to depose federal officers, it potentially interferes with the exercise of federal authority. Because Rule 202 does not require courts to address affirmative defenses that may arise in the future,[100] it could potentially bypass the federal qualified immunity defense, which helps shield federal officials from excessive discovery.[101] Section 1442

95. *See* Price v. Johnson, 600 F.3d 460, 462 (5th Cir. 2010) (discussing the district court's reasoning and dismissing the appeal for lack of appellate jurisdiction to review the particular grounds for remand).

96. *See* Willingham v. Morgan, 395 U.S. 402, 405–06 (1969) (detailing the purpose and history of federal officer removal statutes); Tennessee v. Davis, 100 U.S. 257, 262–65 (1879) (explaining the purpose of federal officer-removal statutes and articulating their constitutional basis in the Necessary and Proper Clause).

97. *Willingham*, 395 U.S. at 406.

98. *Id.* at 406–07 (citations omitted).

99. Murray v. Murray, 621 F.2d 103, 107 (5th Cir. 1980).

100. *See supra* notes 29–33 and accompanying text.

101. *See* Ashcroft v. Iqbal, 219 S. Ct. 1937, 1953 (2009) ("The basic thrust of the qualified-immunity doctrine is to free officials from the concerns of litigation, including 'avoidance of disruptive discovery.'" (quoting Siegert v. Gilley, 500 U.S. 226, 236 (1991) (Kennedy, J., concurring))).

addresses this precise situation—where removal to federal courts is necessary to assert federal defenses that state courts might not otherwise respect.[102]

Thus, even if Iqbal had been a Texas plaintiff, Rule 202 should not have helped his case. Had Iqbal filed Rule 202 petitions to depose Attorney General Ashcroft, Director Mueller, or other federal officers, the defendants could have removed to federal court where the federal rules do not permit pre-suit depositions to investigate potential claims.[103] Thus, Rule 202 will rarely if ever be used to depose federal officials. Rule 202 can, however, be useful in potential § 1983 claims against state officials. As a policy matter, this makes sense. If Texas wants to open its own officials to pre-suit discovery via Rule 202, that should be a matter for Texas courts to decide.

IV. Preemption of Rule 202

Because Rule 202 proceedings are typically not removable, they will generally remain in Texas courts even when the proceedings implicate potential federal claims. There are, however, still obstacles to utilizing Rule 202 for potential federal claims in state court. The most significant is that, depending on the nature of the federal claim and the implicit or explicit role that it plays in the case, Rule 202 might be preempted by the Reverse Erie doctrine. When Rule 202 implicates federal claims implicitly, the pre-suit depositions are justified solely on the basis of potential state claims. The possibility of federal claims simply lurk implicitly in the background. But in some instances, plaintiffs may not be able to justify pre-suit depositions through state claims alone and may be forced to justify the benefits of pre-suit depositions by *explicitly* discussing potential federal claims.

Rule 202 will not be preempted when the federal claims are merely implicit. When Rule 202 proceedings explicitly rely on federal claims to justify pre-suit depositions, however, preemption would be appropriate for certain federal claims. In this Part, I begin with an overview of the Reverse Erie doctrine. Next, I examine Reverse Erie preemption based on implicit federal claims. Finally, I apply Reverse Erie to explicit federal claims.

A. The Reverse Erie Doctrine

Reverse Erie is a federal common law doctrine that governs choice-of-law issues when state courts hear federal claims.[104] State courts of general

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102. The federal qualified immunity defense is particularly important to § 1442. *See Willingham*, 395 U.S. at 405 ("[T]he test for removal should be broader, not narrower, than the test for official immunity.").

103. *See supra* note 42.

104. *See* Kevin M. Clermont, *Federal Courts, Practice & Procedure—Reverse-*Erie, 82 NOTRE DAME L. REV. 1, 4, 20 (2006) ("Just as the *Erie* methodology itself is specialized federal common law, the reverse-*Erie* judicial choice-of-law methodology is a federal-common-law creation of the U.S. Supreme Court that the state courts must follow."). Whereas "standard" Erie doctrine applies

jurisdiction cannot decline to hear cases based on federal law,[105] but as a general rule, state courts are free to apply their own procedure.[106] While the Reverse Erie doctrine occasionally forces states to adopt federal procedure, preemption is the exception and not the rule. There is a "presumption against pre-emption" due to concerns over state judicial autonomy.[107]

Given its ability to affect the outcome of exclusive federal claims or future suits in federal court, Rule 202 undermines a central premise of the presumption against preemption. For example, many cases cite a famous article by Professor Hart to support arguments in favor of state and local rules.[108] Hart argued that while Congress can force states to enforce federal rights, "federal law takes the state courts as it finds them."[109] If Congress wants certain claims to be governed by federal procedure, Congress can grant exclusive jurisdiction to the federal courts.[110] Congress does not have this option with Rule 202. Even if Congress grants exclusive jurisdiction, plaintiffs can still seek pre-suit depositions under Rule 202, and those proceedings will generally not be removable to federal court.[111]

The presumption against preemption should not be overstated. As the Supreme Court has explained, "Federal law takes state courts as it finds them only insofar as those courts employ rules that do not 'impose unnecessary burdens upon rights of recovery authorized by federal laws.'"[112] Thus, despite concerns over state judicial autonomy, the Reverse Erie doctrine will occasionally preempt state law. Though the Reverse Erie doctrine is not well-defined,[113] the Supreme Court has frequently considered two factors in its leading Reverse Erie cases. First, the Court has asked whether the state

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when federal courts sitting in diversity hear state claims, Reverse Erie deals with the opposite scenario—when state courts hear federal claims.

105. Testa v. Katt, 330 U.S. 386, 394 (1947).

106. Johnson v. Fankell, 520 U.S. 911, 919 (1997); *see also* Henry M. Hart, Jr., *The Relations Between State and Federal Law*, 54 COLUM. L. REV. 489, 507 (1954) (describing how Hamilton, in the *Federalist No. 82*, predicted that absent special prohibitions, state courts would enforce federal law as they do their own); Daniel J. Meltzer, *State Court Forfeitures of Federal Rights*, 99 HARV. L. REV. 1128, 1131 (1986) (asserting that long ago the Supreme Court declared that state law and practice are just as applicable when federal rights are in controversy). *But see* Clermont, *supra* note 107, at 34 ("[T]here is no reason that state interests in state court should weigh more heavily than federal interests do in federal court. Any presumption here in favor of state law, like the presumption against preemption, is more a figure of speech than a real rule.").

107. *See Fankell*, 520 U.S. at 918–19 (discussing the basis for the "normal presumption against pre-emption").

108. *See, e.g.*, *id.* at 919; Felder v. Casey, 487 U.S. 131, 150 (1988).

109. Hart, *supra* note 106, at 508.

110. *Id.* at 507.

111. *See supra* notes 73–76 and accompanying text.

112. *Felder*, 487 U.S. at 150 (citations omitted).

113. *See* Clermont, *supra* note 104, at 2 ("While everyone has an *Erie* theory and stands ready to debate it, almost no one has a theory of reverse-*Erie*, and no one at all has developed a clear choice-of-law methodology for it: reverse-*Erie*, often misunderstood, mischaracterized, and misapplied by judges and commentators, goes strangely ignored by most scholars.").

procedure unnecessarily burdens or interferes with federal law. Second, the Court has examined whether the application of state procedure would be outcome determinative.

In several leading Reverse Erie decisions, state procedures were preempted for their interference with federal rights. For example, *Dice v. Akron, Canton & Youngstown Railroad Co.*[114] preempted an Ohio practice in which judges could resolve factual questions of fraud.[115] The Supreme Court held that, for Federal Employers' Liability Act (FELA) cases, the jury must decide factual issues of fraud because the right to a jury trial was "part and parcel of the remedy afforded railroad workers under [FELA]."[116] Similarly, *Brown v. Western Railway of Alabama*[117] preempted Georgia's strict pleading standards due to the standards' burden on FELA rights.[118] The Supreme Court forced Georgia to apply more lenient federal pleading standards, holding that "[s]trict local rules of pleading cannot be used to impose unnecessary burdens upon rights of recovery authorized by federal laws."[119] If states could defeat federal rights under the guise of local practice, "desirable uniformity in [the] adjudication of federally created rights could not be achieved."[120]

Unlike most Reverse Erie cases, however, where state procedures restrict federal rights, Rule 202 arguably expands them. Rule 202 extends access to discovery, which can help plaintiffs enforce their federal rights (i.e., their potential federal claims). In reality, though, the distinction is inconsequential: while states may not unnecessarily burden federal rights, neither may they impermissibly expand them. In *Atlantic Coast Line Railroad v. Burnette*,[121] a state law expanded plaintiffs' rights by extending the statute of limitations for FELA claims.[122] The Supreme Court invalidated the extension, holding that Congress created the right and in doing so set the limits of that right.[123] The distinction between restricting and expanding federal rights is therefore irrelevant to the Reverse Erie analysis. When Rule 202 interferes with a cause of action that represents a congressionally determined balance of rights, Rule 202 should be preempted.

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114. 342 U.S. 359 (1952).

115. *Id.* at 362–63.

116. *Id.* at 363 (internal quotations omitted).

117. 338 U.S. 294 (1949).

118. *Id.* at 298–99.

119. *Id.*

120. *Id.* at 299.

121. 239 U.S. 199 (1915).

122. *See id.* at 200 (referring to FELA as "the Employers' Liability Act of April 22, 1908," and holding that recovery after the expiration of the statute of limitations was an error).

123. *See id.* at 201 ("[W]hen a law that is relied on as a source of an obligation in tort, sets a limit to the existence of what it creates, other jurisdictions naturally have been disinclined to press the obligation farther.").

Outcome determination is another important Reverse Erie consideration. In *Felder v. Casey*,[124] a Wisconsin statute imposed stringent notification conditions before plaintiffs could sue government officials in state court and required that plaintiffs refrain from filing suit for 120 days after the notification.[125] The Court preempted the statute on two grounds. First, the notice requirement imposed a burden that was "inconsistent in both design and effect with the compensatory aims of the federal civil rights laws."[126] Second, the Court held the enforcement of the Wisconsin statute would "predictably produce different outcomes in federal civil rights litigation based solely on whether that litigation takes place in state or federal court."[127] The Court prohibited the states from applying "such an outcome-determinative law when entertaining substantive federal rights in their courts."[128]

B. Implicit Federal Claims

Rule 202 is not preempted as a result of implicit federal claims. If Rule 202 could be preempted based on the inferred presence of potential federal claims, the result would eviscerate Rule 202. In such a scenario, petitions to investigate potential state claims could be preempted based on the mere speculation that potential federal claims might exist. Many Rule 202 proceedings, which often occur in the early stages of investigation, will contain at least a remote possibility of federal causes of action. Because Rule 202 does not require plaintiffs to clearly define the potential claims, this possibility will exist in almost all cases.[129] Furthermore, attempts to clearly define potential claims could lead to miniature trials on the merits of those claims.

Thus, if federal law could preempt Rule 202 based on the mere specter of potential federal claims, a large number of Rule 202 proceedings would be preempted. It would force Texas to restructure the operation of pre-suit discovery. Additionally, as established by the Supreme Court, respect for

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124. 487 U.S. 131 (1988).

125. *Id.* at 134. The 120-day delay gave the defendant "an opportunity to consider the requested relief." *Id.*

126. *Id.* at 141.

127. *Id.*

128. *Id.* In another leading Reverse Erie case, the outcome-determination test reached a different result. In *Johnson v. Fankell*, Idaho law did not grant the defendants an interlocutory appeal, contrary to federal practice, for the dismissal of their qualified-immunity defense. Johnson v. Fankell, 520 U.S. 911, 920 (1997). The Court held that, unlike the notice-of-claim statute in *Felder*, the Idaho appeals procedure was not outcome determinative—the claim would still be reviewable by the Idaho Supreme Court, and thus, the procedure would not affect the ultimate outcome of the case. *Id.* at 920–21.

129. If Rule 202 required plaintiffs to clearly state potential claims, it would contradict its goal of helping plaintiffs determine whether they even had a cause of action at all. *See supra* notes 19–20 and accompanying text.

state procedures and judicial autonomy must reach an "apex when . . . federal law requires a State to undertake something as fundamental as restructuring the operation of its courts."[130] The presumption against preemption is strengthened when dealing with "a neutral state Rule regarding the administration of the state courts."[131]

In our system of federalism, it is important that states retain control of their own judicial procedures. Accordingly, several leading Reverse Erie cases discussing the federal/state concern indicate that the Reverse Erie doctrine has often been applied to inconsequential state procedures. In his survey of federal claims in state courts, Professor Meltzer identified several recurring themes in the cases where the Supreme Court mandated federal law over state law.[132] Many cases dealt with state practices that were inconsistently followed[133] or with novel procedural requirements that surprised litigants and denied them an adequate opportunity to comply.[134]

Conversely, Rule 202 plays an important role in Texas courts. Unlike many of the procedures identified by Professor Meltzer, Rule 202 has been consistently applied and is not novel within the context of Texas litigation. In fact, Rule 202 petitions are granted almost as a matter of course, with a recent study showing that the majority (60%–70%) of petitions were granted.[135] Furthermore, Rule 202 proceedings are common in Texas—a recent study by Professor Hoffman shows that 53% of Texas attorneys have had some experience either serving or receiving notices of pre-suit depositions under Rule 202.[136]

Thus, when dealing with implicit federal claims, state autonomy concerns will weigh heavily against the preemption of Rule 202. Rule 202 petitions implicate *potential* federal claims; they do not involve *actual* federal claims. Potential claims are often vaguely defined and may never develop into actual suits. When plaintiffs are still investigating potential claims, there will often be at least some possibility for a federal cause of action. Reverse Erie has never been applied to situations based purely on the speculation that federal claims may materialize in the future.

C. *Explicit Federal Claims*

Rule 202 will only allow pre-suit depositions when the likely benefits of the depositions outweigh the burdens of the procedure. Typically the likely benefits are simply the potential claims. In most cases, plaintiffs will not

130. *Fankell*, 520 U.S. at 922.
131. *Id.* at 918.
132. Meltzer, *supra* note 106, at 1137–45.
133. *Id.* at 1138.
134. *Id.*
135. Hoffman, *supra* note 2, at 258.
136. *Id.* at 251.

need to mention potential federal claims because many federal causes of action have corresponding state causes of action.[137] If state causes of action are insufficient to justify Rule 202 depositions, however, the plaintiff may be forced to explicitly include potential federal claims. Explicit federal claims raise strong Reverse Erie concerns, and preemption could be analyzed under two theories. First, Rule 202 could be preempted because it undermines the uniformity of federal pleading standards. Second, Rule 202 could be preempted due to its interference with the underlying federal claims.

1. Preemption Based on Federal Pleading Standards.—If Rule 202 could be preempted based on federal pleading standards, preemption would occur any time a Rule 202 petition relied explicitly on a potential federal claim, which would promote uniformity in the federal courts. Federal pleading standards serve a gatekeeping function that plaintiffs must pass before they are entitled to discovery.[138] Rule 202 opens the doors to discovery for Texas plaintiffs. With Rule 202, Texas plaintiffs could investigate claims without first satisfying *Twombly*'s flexible plausibility standard—with Rule 202, the plaintiff is not even required to state a viable claim.[139]

Some aspects of the Reverse Erie doctrine support the preemption of Rule 202 due to its interference with federal pleading standards. To begin, the Reverse Erie doctrine looks to (1) whether the application of Rule 202 would be outcome determinative, and (2) whether it unnecessarily burdens a federal right.[140] Regarding the former, Rule 202 will generally be outcome determinative. Relative to the federal courts, Texas sets a far lower standard for plaintiffs to reach discovery, which will lead to both vertical (intrastate) and horizontal (interstate) forum shopping.[141] Rule 202 provides access to the discovery process for potential plaintiffs who might otherwise have their cases dismissed in federal court—the raison d'être of this Note. While it

137. *See* Scott Dodson, *Federal Pleading and State Presuit Discovery*, 14 LEWIS & CLARK L. REV. 43, 61 (2010) (asserting that states "generally recognize analogous causes of action" for exclusive federal claims).

138. *See* Ashcroft v. Iqbal, 129 S. Ct. 1937, 1950 (2009) (describing Rule 8 and pleading standards as the "doors of discovery" and holding that a plaintiff cannot unlock those doors with mere conclusions).

139. *See supra* note 19 and accompanying text.

140. *See supra* subpart IV(A).

141. The outcome-determination test arguably differs between standard Erie and Reverse Erie. Standard Erie promotes uniformity by discouraging vertical forum shopping and avoiding an inequitable administration of the laws due to state citizenship. *See* Clermont, *supra* note 104, at 36 (elaborating on the twin aims of *Erie*). In addition to these considerations, Reverse Erie considers horizontal forum shopping. *Id.* ("[H]ere the bigger danger is choosing among state court systems on matters of federal concern, rather than between state and federal court systems . . . . Federal rights and duties should not vary from state to state.").

could be argued that the outcome difference is beneficial,[142] the inquiry in Reverse Erie situations is not whether outcome differences are beneficial or harmful but instead whether the differences exist at all.[143] Rule 202 offers potential plaintiffs in Texas courts a significant advantage relative to potential plaintiffs in other states.

In addition to outcome determination, Reverse Erie cases also ask whether the state procedure burdens a federal right and whether the burden conflicts in purpose or effect with a federal right at issue. This assessment is made "in light of the purpose and nature of the federal right."[144] If an entitlement to federal pleading standards were considered a federal right, then part of the standards' purpose would be a gatekeeping function to prevent undue discovery.[145] Rule 202 burdens that right by creating an end around in the form of pre-suit depositions. By expanding access to discovery, Rule 202 conflicts with one of the purposes of federal pleading standards, as explained by *Iqbal* and *Twombly*.

A fundamental problem with this argument is that pleading standards should not be considered federal rights. Although the distinction between substance and procedure can be problematic,[146] there are many reasons why pleading standards should not be considered substantive in the Reverse Erie context. To begin with, both the *First Restatement of Conflict of Laws* and the *Second Restatement of Conflict of Laws* characterize rules of pleading as procedural.[147] Furthermore, unlike other Reverse Erie cases where the underlying federal rights are typically created by congressional statute, pleading standards derive from Rule 8 of the Federal Rules of Civil Procedure. The Federal Rules, which were authorized by the Rules Enabling Act (REA), are by definition procedural: the REA authorizes the Supreme Court to prescribe rules, but "[s]uch rules shall not abridge, enlarge or modify any substantive

142. In a study by Professor Hoffman, a majority of lawyers reported that "a prime purpose for taking presuit discovery was to make sure that the case they were going to subsequently file would be valid under the rules." Hoffman, *supra* note 2, at 255.

143. *See* Clermont, *supra* note 104, at 36 (characterizing the problem of outcome differences as the "unfairness of treating similarly situated persons differently in a substantial way simply because certain classes of people have a choice of court systems").

144. Felder v. Casey, 487 U.S. 131, 139 (1988).

145. *See supra* note 138 and accompanying text.

146. In a leading Reverse Erie case, the Supreme Court considered whether local pleading rules were substantive or procedural. Brown v. W. Ry. of Ala., 338 U.S. 294, 296 (1949). The Court noted, "To what extent rules of practice and procedure may themselves dig into 'substantive rights' is a troublesome question at best . . . . Other cases in this Court point up the impossibility of laying down a precise rule to distinguish 'substance' from 'procedure.'" *Id.* (citations omitted). The Court decided the case on other grounds. *Id.* at 299.

147. *See* RESTATEMENT (SECOND) OF CONFLICT OF LAWS § 127 (1971); RESTATEMENT (FIRST) OF CONFLICT OF LAWS § 592 (1934).

right."[148] Rule 8 establishes a transsubstantive rule that governs pleading standards;[149] it does not create a substantive right.

Moreover, federal pleading standards do not preempt state procedure when state courts adjudicate concurrent federal claims. If federal pleading standards were substantive rights and strict adherence were necessary to maintain a uniform approach to discovery, preemption would be necessary for both Rule 202 and state pleading standards whenever federal claims were involved. It would be ineffective to preempt one without the other. The Reverse Erie doctrine has not preempted state pleading standards for concurrent federal claims.[150] Neither should it preempt Rule 202.[151]

2. Preemption Based on Potential Federal Claims.—Alternatively, Rule 202 could be preempted due to its interference with federal claims. Because Rule 202 will generally be outcome determinative,[152] preemption will depend on whether Rule 202 unnecessarily burdens a federal right (i.e., the potential federal claims that were explicitly relied upon to justify pre-suit depositions). In other words, does Rule 202 conflict with the nature and purpose of that federal right?

This determination will vary depending on the potential federal claims at stake.[153] For example, patent laws represent a careful balance of rights to be adjudicated exclusively by federal courts, and any state interference is impermissible.[154] Rule 202 disrupts federal uniformity, and it conflicts with the federal nature of patent law. Rule 202 should be preempted whenever patent claims are explicitly involved. If patent claims are merely implicit, as

148. 28 U.S.C. § 2072(b) (2006).

149. Ashcroft v. Iqbal, 129 S. Ct. 1937, 1953 (2009).

150. For an analysis on whether state pleading standards should be preempted, see Z.W. Julius Chen, Note, *Following the Leader:* Twombly, *Pleading Standards, and Procedural Uniformity*, 108 COLUM. L. REV. 1431 (2008).

151. There is, however, a key difference between Rule 202 and the typical scenario in which state courts exercise concurrent jurisdiction over federal claims. The latter scenario is contained in state court. With Rule 202, the plaintiff could theoretically file a petition for pre-suit deposition in Texas state courts and subsequently file suit in federal court.

152. *See supra* notes 124–43 and accompanying text.

153. If this is true, the effectiveness of federal pleading standards in Texas may vary by the substantive cause of action, depending on whether Rule 202 is preempted for its interference with a potential federal claim. This would seemingly conflict with *Iqbal*'s holding that pleading standards are transsubstantive rights. But preemption under Reverse Erie has always been based on the cause of action asserted. *Compare, e.g.*, Felder v. Casey, 487 U.S. 131 (1988), Dice v. Akron, Canton & Youngstown R.R. Co., 342 U.S. 359 (1952), *and* Brown v. W. Ry. of Ala., 338 U.S. 294 (1949) (all preempting state procedure based on the plaintiff's cause of action), *with* Johnson v. Fankell, 520 U.S. 911 (1997) (declining to preempt state procedure for a particular substantive right). Rule 202 preemption should be analyzed through the asserted cause of action, i.e., the potential claims at issue.

154. *See generally* Bonito Boats, Inc. v. Thunder Craft Boats, Inc., 489 U.S. 141, 160 (1989) (invalidating a state law due to its interference with federal patent laws).

was the case with *U.S. Filter*,[155] the court could limit the scope of the pre-suit depositions to preclude questions related solely to patent infringement.[156]

V. Conclusion

Plaintiffs must pass two hurdles before they can use Rule 202 to investigate potential federal claims. First, they must keep the proceedings out of federal court. If a Rule 202 proceeding is removed to federal court, it will likely be dismissed. Second, plaintiffs must prevent preemption in state court. Even if Rule 202 proceedings are not removable, the Reverse Erie doctrine might preempt Rule 202 in state courts.

Despite the potential impact on federal claims and federal courts, Rule 202 proceedings will generally not be removable because federal district courts lack federal-question and diversity jurisdiction. However, removal would still be possible in two scenarios as long as Rule 202 proceedings are properly considered civil actions under § 1441. First, removal would be possible in the limited circumstance where other statutes—aside from the federal-question and diversity statutes—grant federal jurisdiction. Second, federal officials can remove Rule 202 proceedings under § 1442. But these situations are not common, and most Rule 202 proceedings will remain in Texas courts.

Yet even if Rule 202 remains in Texas courts, it might be preempted through the Reverse Erie doctrine when plaintiffs explicitly use potential federal claims to justify pre-suit depositions. The implicit possibility of federal claims will be insufficient; the plaintiff must explicitly rely on potential federal claims. Preemption will vary depending on the potential federal claims at issue. When Rule 202—and its broad grant of pre-suit discovery—conflicts with the nature and purpose of a potential federal claim, Rule 202 should be preempted with respect to that claim.

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155. The potential claims consisted of state contract claims and a federal patent-infringement claim. Though potential patent claims existed, the pre-suit depositions were justified solely based on state contract claims. *See supra* notes 6–8 and accompanying text.

156. In *Iqbal*, the majority declined to "relax the pleading requirements on the . . . promises [of] . . . minimally intrusive discovery." Ashcroft v. Iqbal, 129 S. Ct. 1937, 1953–54 (2009). The Court held that "a motion to dismiss a complaint for insufficient pleadings does not turn on the controls placed upon the discovery process." *Id.* at 1953. *Iqbal* thus suggests that Rule 202 petitions should not be granted on the promise of carefully cabined discovery.

There is, however, a key distinction between the Rule 202 scenario and *Iqbal*. In *Iqbal*, the plaintiff did not have any other claims. When dealing with implicit federal claims, the Rule 202 depositions have already been justified by the state claims alone. Therefore, the reasoning in *Iqbal* does not apply. For explicit federal claims, carefully managed discovery will be irrelevant. Plaintiffs will only mention potential federal claims when they have no other choice. The federal claims are essential for the justification of the pre-suit depositions. Thus, it would be inconsistent to approve depositions to investigate potential federal claims while simultaneously limiting the depositions to preclude the investigation of those federal claims.

If Texas plaintiffs can overcome these two obstacles, they can use Rule 202 to their advantage. The broad scope of Rule 202 gives plaintiffs in Texas an opportunity to conduct pre-suit depositions without having to meet federal pleading standards, and after taking pre-suit depositions, plaintiffs can theoretically file in either federal or state court. Rule 202 allows some plaintiffs, who would otherwise have their cases dismissed under *Twombly* and *Iqbal*, to bring suit in federal court. Even though it is a state procedure, Rule 202 can have an outcome-determinative effect on cases in federal court. Rule 202 offers plaintiffs a powerful tool, and it presents courts with interesting questions of federalism, jurisdiction, and preemption.

—*Jeffrey Liang*

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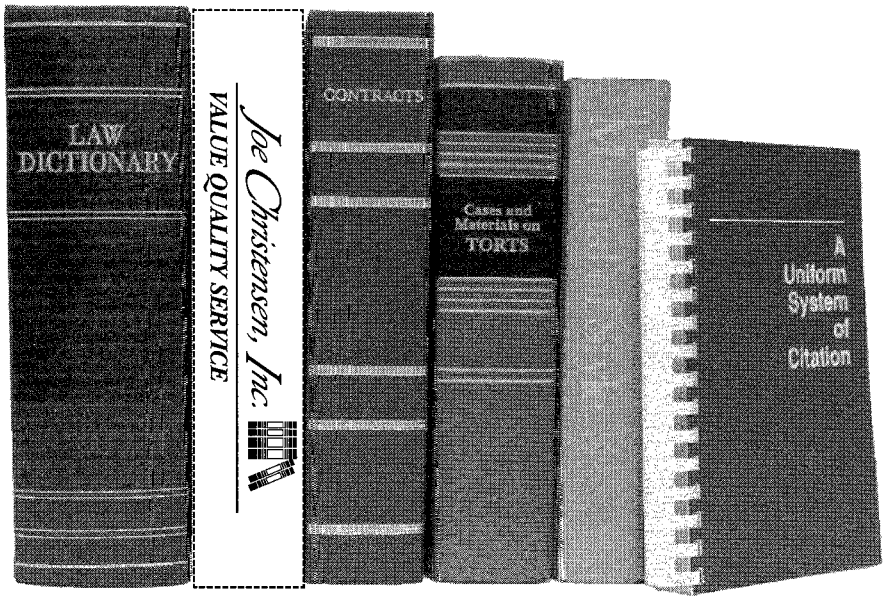

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