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ARTICLE

ENERGY AND ACQUISITION: HISTORY AND PROSPECTS FOR ANTI-MERGER LEGISLATION IN THE OIL INDUSTRY

DANIEL M. CRANE*

Decontrol of domestic oil prices has focused attention on the oil companies' use of their substantial profits. In 1979, a bill sponsored by Senator Edward M. Kennedy (S. 1246: The Oil Windfall Acquisition Act of 1979) was favorably reported by the Senate Judiciary Committee, but was not acted upon by the Senate as a whole. The bill would have amended the Clayton Act to forbid the major oil companies from engaging in certain horizontal and conglomerate mergers. S. 1246's primary purpose was to encourage energy development and the eventual energy independence of the United States.

Mr. Crane outlines the major provisions of the legislation and provides a basis for examining the antitrust and energy implications of restrictions on oil-company acquisitions. He argues that a significant aspect of the bill — regulation of conglomerate mergers — has received bipartisan support and remains a justifiably active concern. Mr. Crane recognizes the difficulties of compromise legislation, given the international ramifications of S. 1246, as well as the conservative tone of the Senate. He notes, however, that the immediacy of the energy crisis warrants continued legislative and public concern with the use of oil company profits.

I. INTRODUCTION

Although one can debate whether the results of the 1980 elections represented a sharp turn to the right, there is little doubt that legislation previously sponsored by liberal Democratics will now face an even more difficult route through Congress. It would be unfortunate if, as a result of its recent political setbacks, the liberal wing of the Democratic party abandoned its efforts to put forth its own brand of legislative solutions. It would be equally unsatisfactory, however, if no attempt were made to tailor these past initiatives to both the legitimate concerns of the conservative opposition and to the new political reality.

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Perhaps no topic so excites the passions of both liberals and conservatives as that of the major oil companies' role in dealing with the nation's energy problems. Whereas liberals view the oil companies with considerable distrust, conservatives generally place their faith in an unfettered private sector. The current political alignment will prevent the liberals from converting their distrust into more pervasive regulation of the energy industry. However, due to the uncertainty and volatility of the energy situation, an entirely laissez-faire approach to the problem is not necessarily preordained. A review of some specific deliberations held by the Ninety-sixth Congress illustrates that although there may have been disagreement over particular proposals, both Republicans and Democrats shared similar concerns with respect to the role that the major oil companies will play in resolving the energy problem.

Over the past several years, oil companies have occasionally chosen to acquire both energy- and non-energy-related enterprises. Among liberal members of Congress, there has been concern that oil company acquisitions of alternative-energy companies ("horizontal mergers") could adversely affect competition within the energy industry. While most conservatives did not share this concern, many Republicans felt that the growing propensity of the oil companies to invest their profits in non-energy-related acquisitions ("conglomerate mergers") represented a potentially troublesome development. In particular, these Republicans were concerned that substantial non-energy-related acquisitions would make it politically difficult to justify the decontrol of domestic oil prices.

On May 24, 1979, Senator Edward M. Kennedy, then-Chairman of the Senate Judiciary Committee, and twelve co-sponsors[1] introduced S. 1246, the Energy Antimonopoly Act of 1979 (later renamed the Oil Windfall Acquisition Act of 1979). This legislation was intended to deal with both horizontal and conglomerate acquisitions by the major oil companies and to use the antitrust laws to promote domestic petroleum exploration and development. Following extensive hearings, the Judiciary Committee (the "Committee"), on November 20, 1979, by a 9 to 8 margin, ordered that S. 1246 be favorably reported to

1 The original co-sponsors of the legislation were Senators Metzenbaum, Bayh, Bumpers, Cranston, DeConcini, Eagleton, Hart, Leahy, Levin, McGovern, Morgan, and Riegle.

the Senate floor.[2] Despite the measure's narrow victory in committee, it fell victim to election-year inaction in 1980.

A. *S. 1246: A Brief Overview*

S. 1246 amends section 7 of the Clayton Act,[3] which forbids mergers or acquisitions whose effect "may be substantially to lessen competition, or tend to create a monopoly," by adding a new section which, with certain exceptions, prohibits the eighteen largest petroleum producing companies operating in the United States[4] from acquiring control of non-energy companies with assets of more than $50 million and from acquiring other energy companies with assets of more than $100 million. According to the report submitted by the Committee on December 4, 1979, the basic purpose of S. 1246 is "to encourage the major oil companies to invest in energy development during the next decade by foreclosing an avenue of investment which is unproductive in the context of the national energy crisis."[5]

Although S. 1246 establishes a formidable barrier to oil company acquisitions, it also contains the following exceptions and refinements to this general ban:

(1) acquisitions which promote energy exploration, extraction, production, or conversion are allowed;
(2) acquisitions which enhance competition in the foreign or domestic commerce of the United States are permitted;
(3) newly created joint ventures in petroleum or alternative energy areas are allowed;
(4) foreign corporations not controlled by domestic producers are excluded from coverage; and
(5) the Justice Department, which is charged with en-

2 Senators Kennedy, Bayh, Byrd, Biden, Culver, Metzenbaum, DeConcini, Leahy, and Baucus supported S. 1246 in committee. Those opposed to S. 1246 were Senators Heflin, Thurmond, Mathias, Laxalt, Hatch, Dole, Cochran, and Simpson. With the exception of Senator Heflin (D. Ala.), the vote was strictly along party lines.

3 15 U.S.C. §§ 12-27 (1976).

4 The eighteen major domestic oil companies covered by S. 1246 are Texaco, Standard Oil of California, Exxon, Mobil, Gulf, Standard Oil of Indiana, Atlantic Richfield, Standard Oil of Ohio, Occidental, Shell, Continental Oil, Getty, Phillips, Marathon, Union Oil of California, Sun, Cities Services, and Amerada Hess. Unlike the other sixteen companies, Standard Oil of Ohio and Shell are controlled by foreign parents.

5 OIL WINDFALL ACQUISITION ACT OF 1979: REPORT OF THE COMM. ON THE JUDICIARY, S. REP. No. 444, 96th Cong., 1st Sess. 3 (1979) [hereinafter cited as S. REP.].

> forcing S. 1246, must be guided by principles of international law and comity when assessing foreign acquisitions.[6]

Two other aspects of S. 1246 must be noted. First, the bill's prohibitions are to remain in effect only for a ten-year period and, second, the burden of showing that a proposed acquisition will either promote energy development or enhance competition rests upon the acquiring company and not the government. This latter provision, by shifting the burden of proof from the government to the proponents of the merger, represents a significant departure from existing antitrust law.

According to the Committee, S. 1246 constitutes but one element in "a comprehensive national effort . . . to relieve America's dependence upon insecure foreign sources for petroleum. . . ."[7] By forbidding the eighteen largest oil companies from spending their financial resources on mergers and acquisitions, the bill's sponsors hope to encourage these companies to invest more heavily in the development of the nation's domestic energy resources.[8] Specifically, the Committee noted that:

(1) the nation urgently requires increased exploration, development, and production of energy;
(2) dependence upon Middle Eastern oil creates costs to society which are not fully reflected in the price of oil;
(3) the major domestic oil companies have the financial resources and expertise to enhance production;
(4) without restrictions, oil companies might divert a considerable amount of revenue to acquisitions which would not enhance the production of energy; and
(5) foreclosing such acquisitions will encourage more socially desirable investment in energy.[9]

According to the Committee, S. 1246 represents:

> the least governmentally intrusive method of channeling large amounts of oil windfall profits away from oil company

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6 *Id.*
7 *Id.* at 1.
8 *Id.*
9 *Id.* at 2.

> acquisitions of department stores or circuses and towards oil company investment in energy. It involves no federal bureaucracy. It requires no governmental auditors to monitor how oil company funds are spent on a day to day basis. It allows oil companies to diversify. And it imposes no restrictions on their ability to find and produce energy.[10]

S. 1246's opponents on the Committee disputed the majority's favorable opinion of the proposed legislation. Enactment of S. 1246, they maintained, would not serve the public interest because:

> (1) applying the bill's prohibitions to one segment of an industry in the economy is discriminatory;
> (2) the bill would reduce domestic production and increase American dependence on imported oil;
> (3) the legislation would increase concentration in the petroleum industry;
> (4) the bill would reduce the level of oil company research and development, thereby inhibiting the emergence of new energy technologies;
> (5) by imposing harmful restrictions on the oil companies, the bill would retard the development of alternative energy sources, including synthetic fuels;
> (6) by prohibiting mergers, the bill would prevent assistance from being rendered to "failing" companies;
> (7) the bill would raise the cost of capital needed to finance new energy exploration and development;
> (8) the bill's extraterritorial application would create major foreign policy difficulties; and
> (9) the legislation would preempt the efficient investment decision-making process of the private sector by placing the federal government in control of managing private money.[11]

Thus, in contrast to the majority's rather optimistic assessment of the bill's probable effects, the minority found that enactment of S. 1246 would disrupt the American economy and actually decrease energy production.[12]

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10 *Id.* at 3.

11 OIL WINDFALL ACQUISITION ACT OF 1979: REPORT OF THE COMM. ON THE JUDICIARY, MINORITY VIEWS, S. REP. No. 444, 96th Cong., 1st Sess. 133-34 (1979) [hereinafter cited as MINORITY REP.].

12 *Id.* at 133.

B. *S. 1246: Future Prospects*

Considering the current Republican majority in the Senate, the minority's vigorous dissent to the Committee's findings indicates that there is little likelihood of future legislative success for legislation identical to S. 1246. However, the divergent viewpoints of the Committee members expressed in the majority and minority reports obscures an underlying identity of goals: the reduction of America's dependence on insecure, foreign sources of petroleum. Indeed, a careful reading of the various positions of the bill's proponents and opponents suggests that a substantially modified version could be accepted by a conservative-minded Congress.[13]

This Article will identify the strengths of the policy arguments presented by the respective sides, to determine where agreement remains possible. Briefly, a revised version of the bill which could receive support from both sides should:

(1) retain the restrictions on conglomerate mergers;
(2) permit overseas non-energy-related joint ventures or acquisitions where such joint ventures are necessary to maintain access to foreign oil supplies;
(3) permit energy-related acquisitions or mergers while providing for a strong monitoring or reporting system to detect any anti-competitive trends in the energy industry; and
(4) strengthen the bill's affirmative defenses and provide for an expeditious administrative determination by the Justice Department of the applicability of these defenses to the proposed transaction.

The continuation of debate on this issue will make a postive contribution to deliberations concerning the nation's energy

13 Opponents of S. 1246 on the Judiciary Committee, such as Senator Dole, expressed serious concern over the propensity of the oil companies to invest their profits in non-energy related acquisitions in another forum — the hearings of the Senate Finance Committee on the Windfall Profits Tax. Senator Dole, the ranking minority member of the Finance Committee, was a particularly strong advocate of a plowback provision which would have exempted the oil companies from the Windfall Profits Tax to the extent that they reinvested their profits in energy-related activities. Although Senator Dole and other proponents of the plowback felt the public was entitled to some assurance that the profits stemming from decontrol should be reinvested in energy-related activities, they felt that the incentive approach of a plowback, rather than the coercive approach of S. 1246, was more appropriate for such purposes. Despite this preference for an incentive rather than a coercive approach, it is significant that such influential Republicans as Senator Dole are also concerned with the problem addressed by S. 1246.

problems and will encourage public discussion of issues which, despite the political realignment which has recently taken place, will remain of critical importance in devising a national energy policy. The success of compromise legislation will depend ultimately on the flexibility of both parties and on the course of events in the energy area itself.

II. Background And Need for Legislation

S. 1246 was proposed in the context of a national energy crisis brought on by rapid growth in energy use, declining domestic oil production, and increasing reliance upon imports. The statistics demonstrating America's increasing energy dependence are well known and the economic, social, and political costs involved have become subjects of widespread concern in this country. Yet no consensus has emerged as to what type of government action, if any, may be desirable or necessary to deal with the problem. S. 1246 reflects a view that the costs of continued energy dependence are intolerable, that government action is needed to ensure sufficient development of domestic energy resources to reduce the United States' energy dependence, and that placing selective restrictions upon the major oil companies is a permissible and effective form of government action.

A. *The Costs of Energy Dependence*

1. The Economic Costs

The Harvard Business School Energy Project has quantified the economic impact of an increase in United States imports from the 1978 level of 9 million barrels a day to a predicted level of 14 million barrels a day by the late 1980's.[14] The direct economic cost of an additional 5 million barrels a day in imports was estimated to be approximately $58 billion a year.[15] The indirect costs to the economy which could be caused by such an increase were estimated to run as high as $100 billion a year.[16] Since the price of imported oil has risen rapidly since the Harvard study was completed, even these estimates now

14 Energy Future: Report of the Energy Project at the Harvard Business School, 47-55 (R. Stobaugh & D. Yergin ed. 1979) [hereinafter cited as Energy Future].
15 *Id.*
16 *Id.*

understate the magnitude of the economic costs of an increased United States reliance on foreign oil.

2. Domestic Policy Considerations

A disruption in the supply of oil available to the United States would significantly depress GNP, increase unemployment, and promote inflation. The five month interruption in supplies which occurred during 1973–1974 increased inflation by 1.8 percent, increased unemployment by 1.7 percent, and reduced GNP by 3 percent.[17] Future supply disruptions are a real possibility, especially if the United States continues to increase its reliance on insecure foreign sources of oil. Supply shortfalls, caused by reductions or inadequate growth in supplies are even more likely to occur and can create serious dislocations in the economy as well. The hardships imposed on the American public by continually rising energy costs and insecure supplies constitute significant social costs of dependence on foreign oil that are not directly reflected in the price of energy or other products.[18]

3. Foreign Policy Considerations

Increased imports have a detrimental effect on American foreign policy by generating international friction over crude oil supplies and national energy policies. For example, American reliance on OPEC oil and the recent events in Iran and Iraq have raised the possibility of increased United States military involvement in the Middle East to protect insecure Persian Gulf oil,[19] thereby increasing the likelihood of confrontation with the Soviet Union. Also, unlike the United States, the Soviet Union is at present relatively self-sufficient in meeting its energy needs. Thus, continued or increased United States reliance on imported oil could have serious adverse consequences for the balance of power between the United States and the Soviet Union. By increasing pressure on world oil supplies, encouraging emphasis

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17 S. REP., *supra* note 5, at 24-25.

18 *Id.* at 20. *See also* T. SCHELLING, MICRO-MOTIVES AND MACRO-BEHAVIOR (1978).

19 CRS REPORT, PETROLEUM IMPORTS FROM THE PERSIAN GULF: USE OF U.S. ARMED FORCE TO ENSURE SUPPLIES (1979) [hereinafter cited as CRS REPORT].

upon self-interest in foreign policy, and aggravating balance-of-payments problems, dependence on imported oil also strains America's relations with traditional allies, such as Western Europe and Japan, who rely more heavily upon imported oil.[20] Finally, dependence on foreign oil imposes constraints upon the formulation and implementation of American foreign policy in matters which involve or concern the countries supplying the oil.

American dependence on foreign oil thus entails substantial political costs. However, these costs, like the social costs discussed above, are not reflected in the price of energy or other products.

B. *The Need for Efforts to Reduce Energy Dependence*

It is generally agreed that the economic, social, and political costs to the United States of energy dependency are very high and that efforts are needed to reduce our energy dependency. The oil industry has long argued that given adequate financial incentives, sufficient oil and gas can be found to end this dependency.[21] Recent increases in the world price of oil and decontrol of domestic oil prices suggest that the financial constraints on domestic exploration and development which arguably have existed in the past will not be a matter for concern in the future. Yet there is considerable controversy as to whether the oil industry can be expected to increase substantially domestic energy exploration and development in response to the increase in oil prices and profitability.[22]

The sponsors of S. 1246 believe that decontrol will not trigger the increased investment in oil and gas exploration and development necessary to alleviate the nation's energy crisis. They point out that the value to the public of increased domestic energy supplies and decreased reliance on imports would not be fully reflected in the price received by domestic energy suppliers because part of the value would consist of eliminating the

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20 S. REP., *supra* note 5, at 20.

21 S. REP., *supra* note 5, at 11. *See also Hearings on Governmental Intervention into the Market Mechanism Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary*, 91st Cong., 1st Sess., pt. II, at 667-68 (1969).

22 S. REP., *supra* note 5, at 24-25. *See also* ENERGY FUTURE, note 14 *supra*.

negative externalities generated by energy dependence.[23] Consequently, domestic energy production may not be expected to rise to a level that would fully satisfy the demand for domestic energy supplies.[24]

Furthermore, even with large increases in energy prices, other avenues of investment may remain comparatively more attractive to the oil industry than oil and gas exploration and development. In particular, sponsors of S. 1246 fear that the major oil companies, with enormous amounts of investment funds available, will channel these funds into large-scale conglomerate and horizontal mergers in pursuit of higher and more certain profits than might be obtainable through oil and gas investments. Recent large-scale acquisitions and acquisition bids by major oil companies have fueled these concerns.[25]

S. 1246 reflects the view that where the public interest in increased domestic energy supplies conflicts with the oil companies' interests in maximizing returns on investment, the public interest must take precedence.[26] Otherwise, the state of energy dependence and vulnerability to shortages which is threatening the American economy will continue.[27] S. 1246 is also premised on the judgment that direct public controls limiting the range of private investment options available to major oil companies are necessary to redirect sufficient investments in order to satisfy the public interest.

C. *Permissibility and Effectiveness of Selective Restrictions on Mergers*

Under S. 1246, only the major oil companies are singled out for imposition of investment restrictions; additionally, the restrictions apply only to certain types of acquisitions. Although this scheme may be considered discriminatory by some, the

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23 S. REP., *supra* note 5, at 20.

24 *Id.* at 28-29.

25 Recent examples include acquisitions of metals and mineral companies by Atlantic Richfield, Conoco, Gulf Oil, Occidental Petroleum, Royal/Dutch Shell, Shell Oil, SoCal, Amoco, Sohio, and Union Oil. Martin, *Oil Companies Challenged on Use of Assets*, N.Y. Times, Mar. 16, 1981, § D, at 1, col. 3.

26 *See* Samuelson, *Kennedy's Anti-Merger Initiative*, NEWSWEEK, Sept. 3, 1979, at 56.

27 S. REP., *supra* note 5, at 76.

Supreme Court has fairly consistently upheld the right of legislatures to enact economic regulation that affects different groups or classes differently or restricts the right to conduct a business in order to serve the public interest.[28] If Congress determines that it is desirable to encourage the production of energy resources and that such production can be stimulated by prohibiting certain transactions, then it is unlikely that a court would overturn this decision.

In considering S. 1246, the Senate Subcommittee on Antitrust and Monopoly expressed the view that the proposed legislation meets all the standards established by the courts for permissible economic regulation. S. 1246 is designed to serve the public interest by alleviating the nation's energy crisis. The major domestic oil companies are in an economic position to help alleviate this crisis. However, it is arguable that they will not undertake investments to alleviate the energy crisis without prodding from the government. These factors lend support for a legislative scheme of selective controls, targeted to achieve maximum effect, similar to the scheme proposed in S. 1246.

Assuming the Senate Subcommittee is correct in its view that the approach taken by S. 1246 to spur domestic energy production is legally permissible, the serious question remains whether the approach is likely to be effective. The view that it would be rests upon at least two important premises that deserve close examination: first, that the major oil companies have the financial capability either to make large-scale acquisitions or to substantially increase energy exploration and development; and second, that the oil companies are more likely to choose the former alternative. The likely effectiveness of the S. 1246 plan depends in large part upon the soundness of these premises as well as on the assumption that the proposed controls

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28 In United States v. Carolene Products Co., 304 U.S. 144, 152 (1938), the Supreme Court noted that

> the existence of facts supporting the legislative judgment is to be presumed, for regulatory legislation affecting ordinary commercial transactions is not to be pronounced unconstitutional unless in the light of facts made known or generally assumed it is of such character as to preclude the assumption that it rests upon some rational basis within the knowledge and experience of the legislators.

See also Nebbia v. New York, 291 U.S. 502, 527-28 (1934); Railway Express Agency v. New York City, 336 U.S. 106 (1949); New Orleans v. Dukes, 427 U.S. 297, 303 (1976); *Exxon Corp.* v. Governor of Maryland, 437 U.S. 117, 124-25 (1978).

are broad enough to achieve the necessary rechanelling of oil company investments.

III. The Capability of the Major Oil Companies to Finance Major Acquisitions

The oil industry cannot engage in the "acquisition spree" proponents of S. 1246 fear unless the industry has sufficient investment capability in the form of cash flow plus borrowing capacity.[29] Even if the oil industry has the financial capability to undertake major acquisitions, it will not do so unless the rate of return obtainable from the enterprises to be acquired exceeds that of increased energy exploration and development.[30]

Although proponents and critics of S. 1246 may agree on these basic principles, they disagree as to whether oil industry cash holdings and cash flow should be evaluated in absolute dollar terms or in relative terms vis-à-vis other industries. Both sides also differ as to the conclusions about investment capability to be drawn from the levels of industry cash holdings and cash flow.

A. *Oil Company Profitability: The Industry View*

The oil industry has taken the position that for purposes of evaluating their investment capabilities, consideration should be focused primarily on cash flow and only secondarily on borrowing capacity.[31] Moreover, the oil industry has argued that

29 Cash flow consists of two elements — the after-tax income which might be distributed to shareholders, leaving the corporation's earning capacity unchanged, and the amount representing the consumption of the corporation's capital assets. Failure to reinvest the latter amount in income-producing assets, will impair the earning capacity of the corporation. The major petroleum companies also have access to external funds such as proceeds derived from long-term borrowing or from the issuance of new shares.

30 William Baxter, recently appointed Assistant Attorney General of the Justice Department's Antitrust Division, has testified that "whether or not substantial investments will be made in the exploration for and the production of petroleum will be determined almost exclusively by the expected level of profitability afforded by such investments, not by the magnitude of cash on hand." *Energy Antimonopoly Act of 1979: Hearings on S. 1246 Before the Subcomm. of Antitrust, Monopoly and Business Rights of the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. 406 (1979) [hereinafter cited as *Act Hearings*] (statement of Prof. William F. Baxter).

31 From 1971 to 1978, cash flow accounted for 70 to 90 percent of capital investment for integrated petroleum companies, as compared to 73 to 86 percent for non-oil com-

its levels of cash flow should not be evaluated in absolute terms but in relative terms vis-à-vis the levels of cash flow typical of other industries.[32] On this basis, the oil companies have long maintained that in relative terms, their profits are not excessive.

Industry profit levels have historically fluctuated both above and below the profit levels in the manufacturing industries, according to the oil companies. Although the jump in oil prices beginning in 1974 enabled the oil companies to obtain higher returns than manufacturing industries during 1975 to 1976, by 1977 this differential had been reversed.[33] From 1976 through 1978, petroleum industry returns on net worth and total capital employed have been below that of manufacturing industries.[34] In real terms, oil companies' percentage returns on invested capital have dropped from 14.8 percent in 1947 to 4.8 percent in 1977, although the levels of invested capital and return on capital have increased in absolute dollar terms.[35]

Although income levels in the oil industry have been increasing with rising oil prices since 1973,[36] and will increase even more steeply with decontrol of domestic oil prices,[37] the industry has argued that several factors significantly reduce the portion of income increases which the oil companies are ultimately able to retain. These factors include the windfall profits tax, increased ordinary federal and state taxes, and increased royalty payments.[38] In addition, industry representatives claim that net-profit figures overstate actual profit levels because the book

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panies. *Id.* at 1202 (statement of Emil Sunly, Deputy Assistant Secretary of the Treasury for Tax Analysis).

32 This argument apparently disputes the fairness of imposing legislative restrictions upon investment made by the oil industry but not those made by other industries. Yet in strict economic terms, the investment capacity of the oil industry (which provides the impetus for imposing restrictions) consists only of the funds and credit available to the oil industry — the funds and credit available to other industries have no direct relevance.

33 *Act Hearings, supra* note 30, at 109 (joint statement of Dr. James P. Wallace, III, Vice-President, and Rantch A. Isquith, Vice-President, Chase Manhattan Bank).

34 *Id.* at 82. Exxon, which in 1978 ranked second in sales among Fortune 500 companies, ranked 278 in terms of return on stockholders' equity.

35 *Act Hearings, supra* note 30, at 604 (statement of Howard W. Blauvelt, Director and former Chairman and Chief Executive Officer, Conoco, Inc.).

36 CHASE MANHATTAN BANK, FINANCIAL ANALYSIS OF A GROUP OF PETROLEUM COMPANIES, 1977, at 32 [hereinafter cited as CHASE ANALYSIS].

37 The Treasury Department has estimated that the oil companies will receive $126.5 billion in incremental sales revenue from 1979 to 1984 as a result of decontrol. *Act Hearings, supra* note 30, at 1206 (statement of Emil Sunly).

38 *Id.*

values assigned to capital consumption (depreciation and depletion) generally do not reflect the full replacement cost of the assets consumed.[39] Since capital consumption is a more important factor in the financial picture of the oil industry than in that of other industries net-profit figures for the oil industry must be discounted to a greater extent.[40] Given these considerations, the oil industry has asserted that it does not in fact have the enormous cash holdings and cash flow available for discretionary investment which sponsors of S. 1246 have ascribed to it.[41]

In support of this conclusion, the oil industry has pointed to two additional pieces of financial information. First, the industry by its nature requires large amounts of current assets for the conduct of ordinary operations. Second, the industry has not been able to finance its capital expenditures wholly out of cash holdings and cash flow but has had to rely on substantial external borrowing.[42] Thus, according to the industry, even though the cash holdings and cash flow may still seem enormous after being discounted to allow for the considerations discussed above, it is not accurate to conclude that investment capability is correspondingly high.

B. *Oil Company Profitability: The Committee View*

In claiming that large acquisitions are a significant prospective danger, proponents of S. 1246 have stressed the immense profits of oil companies measured in absolute dollar terms.[43] Further, they argue that even in relative terms returns in the oil industry have begun to substantially outstrip those in other industries. Although oil companies' rates of return had historically been

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39 S. REP., *supra* note 5, at 31.

40 *Act Hearings*, *supra* note 30, at 1202 (statement of Emil Sunly).

41 *Id.* at 1206. The Treasury's analysis does not appear to support the contentions of S. 1246's sponsors that decontrol will so enrich the oil companies that an acquisition spree is feasible or likely.

42 A comparison of retained cash flow versus capital expenditures over the 1970 to 1978 period shows that in all of the years except 1973, capital expenditures exceeded cash flow by amounts ranging from $0.6 billion to $4.9 billion. *Act Hearings*, *supra* note 30, at 40 (Wallace and Isquith statement).

43 99 CONG. REC. S6702 (daily ed. May 24, 1979) (remarks of Sen. Edward M. Kennedy) [hereinafter cited as *Kennedy Remarks*].

consistent with those of manufacturing companies (*i.e.*, 13 to 14 percent), by the first quarter of 1979 their rates of return were running from 19 to 32 percent above the average for manufacturing companies.[44] While American corporations as a whole had an estimated 28.5 percent increase in profits in the first quarter of 1979, the oil industry's increase was 56.9 percent.[45] With further oil price increases since 1979, the oil industry has continued to receive disproportionately high returns relative to other industries, and it is likely to continue to do so in the future given the large price increases already instituted since decontrol.

Proponents of S. 1246 have further argued that the actual profitability of the oil companies is even greater than the profit figures indicate because the companies use a variety of accounting techniques to minimize the reported figures. For example, the value of capital assets such as oil and gas reserves has increased dramatically in recent years, but these increases have not been reflected in the book values assigned to the assets. As a result, oil industry wealth has been correspondingly understated.[46] Yet the oil companies have been able to take advantage of "off-book" increases in the actual value of assets to increase their borrowing capacity. With expanded borrowing capacity, the oil companies are in a position to undertake larger investments, whether in energy exploration and development or in acquisitions.

The bill's sponsors have alleged that capital-expenditure figures cited by the oil industry are misleading and overstate the amount of investment undertaken for energy exploration and development. These figures apparently include capital expenditures not only for energy purposes but also for acquisitions as well.[47] Supporters of S. 1246 have also pointed out that while the oil companies may have partially financed their capital expenditures through external borrowing, their enormous cash flows have enabled them to rapidly retire debt; furthermore, they argue the ability of the oil companies to finance their capital

44 S. REP., *supra* note 5, at 40.

45 *Id.*

46 Stobaugh & Yergin, *After the Second Shock: Pragmatic Energy Policies*, FOREIGN AFFAIRS, Spring 1979, at 847; S. REP., *supra* note 5, at 35.

47 S. REP., *supra* note 5, at 40. *See also Act Hearings*, *supra* note 30, at 386-87 (statement of Dr. William A. Lovett).

needs internally has far exceeded that of firms in other sectors of the economy.[48]

For these reasons, supporters of S. 1246 have strongly argued that the oil industry possesses enormous investment capability.

C. *The Likelihood of an "Acquisition Spree"*

Mounting cash flows provide a variety of investment options for oil company management. Supporters of S. 1246 are concerned that oil companies will find acquisitions to be the most attractive vehicle for their large cash surpluses. Some support for this view can be found in the fact that in 1974 — the one year in which retained cash flow exceeded capital expenditures — the oil companies doubled the rate at which they made acquisitions.[49] In addition, as increases in oil industry cash flows have accelerated in the last several years, acquisitions by the oil industry have also grown.[50] During 1976 to 1978, the top 18 oil companies made or proposed acquisitions totalling $7.5 billion.[51] In the first ten months of 1979 alone, actual or proposed acquisitions totalled $7.3 billion.[52] In just the first three months of 1981, actual and proposed acquisitions have totalled more than $6 billion.[53]

These large-scale acquisitions by the oil companies have fostered the perception that imposition of investment restrictions on oil companies may be necessary to prevent diversion of their

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48 PETROLEUM INDUSTRY COMPETITION ACT OF 1976: REPORT OF THE SENATE COMM. ON THE JUDICIARY, 94th Cong., 2d Sess. 62-64 (1976).

For the 27 oil companies in the Chase Manhattan Petroleum Group, the net issuance of long-term debt and stock between 1976 and 1978 was less than $15 billion compared to over $100 billion of capital expenditures. Between 1974 and 1978, these companies financed 85 percent of their capital expenditures out of current operations. S. REP., *supra* note 5, at 40.

49 *Act Hearings*, *supra* note 30, at 393 (statement of Dr. William A. Lovett).

50 According to one analyst: "We estimate that this (acquisition of other resource companies: chemicals, forest products, nonferrous metals) will be the most active area of purchases and mergers and will represent one of the largest sectors of oil company spending. . . . We expect the major oil companies to move billions of dollars into takeovers of companies." Maxwell, *The Great Cash Flow Machines — Part II*, 432 ENERGY PROJECTIONS 7 (1978). *See also The New Oil Game: Diversification*, BUSINESS WEEK, April 24, 1978, at 76-88.

51 S. REP., *supra* note 5, at 37 and exhibit B (list of proposed or actual oil company acquisitions).

52 *Id.*

53 Martin, *supra* note 25.

investment funds away fron energy-producing enterprises. Some economists have expressed concern "that the[se] purchases may not represent the most efficient use of scarce capital."[54] Former President Carter's Special Assistant for Consumer Affairs and the Director of the Bureau of Competition of the FTC have expressed the opinion that the government and the American people are entitled to ensure that the surplus funds received by oil companies as a result of price decontrol are spent in energy-producing enterprises. "If research and development is the reason the oil industry will be allowed to keep part of the windfall under the President's program, we must make sure that the money is being used for these purposes."[55]

Critics of S. 1246, however, have taken the position that capital expenditures for acquisitions should not be considered in absolute dollar terms but in relative terms vis-à-vis total capital expenditures.[56] Although the oil companies have devoted a higher percentage of cash flow or total investment funds to acquisitions than have non-oil companies, these acquisitions appear to be largely in other energy-related, natural resource, and minerals industries.[57] According to officials of the Chase Manhattan Bank, non-energy-related acquisitions represent but a small fraction of the funds reinvested by the oil companies and the hard dollar data totally refutes the notion that the major oil companies are neglecting their longstanding commitments to the U.S. petroleum industry and are diverting significant financial resources to other lines of business.[58] Between 1968 and 1977, six percent of the capital expenditures of the 27 oil companies studied by Chase Manhattan Bank have been in non-energy areas, and major non-energy mergers not included in capital expenditures amounted to only 3 percent of capital outlays between 1974 and 1977. According to one witness at the

54 *Id.*; *Energy Antimonopoly Act of 1979: Hearings on S. 1246 before the Senate Comm. on the Judiciary*, 96th Cong., 1st Sess. 815 (1979) [hereinafter cited as *Committee Hearings*]

55 *Committee Hearings*, *supra* note 54, at 628 (statement of Esther Peterson, Special Assistant to the President for Consumer Affairs). *See Act Hearings*, *supra* note 30, at 238 (statement of Alfred Dougherty, Director of Competition, Federal Trade Commission).

56 *Act Hearings*, *supra* note 30, at 1205 (statement of Emil Sunly).

57 *Small and Independent Business Protection Act of 1979: Hearings Before the Subcomm. on Antitrust and Monopoly of the Senate Judiciary Comm. on S. 600*, 96th Cong., 1st Sess. 12 (1979) [hereinafter cited as *S. 600 Hearings*] (response of Dep't. of Energy to questions by Sen. Gravel).

58 *Act Hearings*, supra note 30, at 110 (Wallace and Isquith statement).

Senate subcommittee hearings on S. 1246, the propensity for huge acquisitions is less prominent in the oil business than in many other sectors of the economy.[59] Thus, critics of S. 1246 have argued that when viewed in the proper perspective, relative to total capital expenditures, oil industry expenditures for acquisitions are not unduly large and do not demonstrate a propensity toward "acquisition sprees."

Opponents of S. 1246 have also argued that such legislation will be self-defeating in the long run. They assert that one factor which dissuades oil companies from investing in additional energy exploration and development is the perceived threat of government intervention reducing the profitability of such investments. Although not directly affecting the value of investing in oil exploration, S. 1246 constitutes a prime example of just such government intervention, according to its critics, and vindicates oil industry concerns.

Several conclusions can be drawn from this discussion. First, it seems clear that the major oil companies which would be affected by S. 1246 have enormous investment funds available in absolute dollar terms. Moreover, for purposes of estimating oil companies' investment capability, the key factor is simply the quantity of investment funds available to these companies; the relative amount of investment funds available to companies in other sectors of the economy has no direct relevance. The conclusion that the investment funds available to the oil companies are more than adequate to enable them to undertake an "acquisition spree" is supported by the rising level of acquisition and merger activity over the last several years.

Second, it seems that some concern over oil industry acquisition activity is warranted if the reduction of American dependence on foreign oil is viewed as an important national interest. Although non-energy acquisitions may not have constituted a substantial proportion of oil companies' total capital expenditures, they have far outstripped expenditures on energy research and development efforts and therefore have not directly contributed to a resolution of the nation's energy problem.[60]

Third, S. 1246 should not itself create a disincentive to oil industry investment in energy exploration and production as

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59 *Act Hearings*, *supra* note 30, at 606-07 (statement by Howard W. Blauvelt).
60 S. REP., *supra* note 5, at 39.

critics have claimed. While legislation such as the windfall profits tax might reasonably give oil companies cause for concern about future government intervention reducing the profitability of investments in energy exploration and production, legislation such as S. 1246 does not justify such concern. Nothing in the bill is aimed at reducing the profitability of energy investments. On the contrary, the thrust of S. 1246 is to *improve* the relative attractiveness of profits to be obtained from energy investments by foreclosing certain *other* avenues of investment. Thus, S. 1246 should not reasonably be expected to chill investments in energy exploration and production. Rather, the level of such investments should still be determined by their expected profitability as compared to the expected profitability of other investment options available. This does raise a difficult question, however, as to whether the restrictions embodied in S. 1246 would be sufficient to accomplish the statute's goal of forcing oil company investments into energy exploration and production. While the statute might foreclose the most attractive avenue of investment — *i.e.*, large scale acquisitions of other enterprises — a number of other investment options would remain open to the oil companies.[61] However, increases in world oil prices and decontrol of domestic oil prices have produced increases in the profitability of energy production which the oil industry has long argued would naturally induce increased investment in energy production. Thus, S. 1246 should perhaps be viewed as an experiment designed to call the oil industry's bluff.

IV. Mergers And Antitrust: A Review

The sponsors of S. 1246 view it as primarily energy rather than antitrust legislation. This observation is shared by well-known antitrust authorities such as Professor Richard Posner of the University of Chicago, who has stated that anti-merger

61 Returning funds to shareholders, although less desirable under existing tax laws, is one possibility. Smaller acquisitions and de novo entry into various fields — especially related fields — are also available to the oil companies although they would involve delays and high transaction costs. *Committee Hearings, supra* note 54, at 490 (statement of Prof. Dennis Mueller, University of Maryland). *See also Act Hearings, supra* note 30, at 151 (statement of Prof. David J. Teece, Stanford University).

legislation such as S. 1246 cannot be defended on an antitrust basis.[62] Nevertheless, the bill contains a substantial antitrust element. Accordingly, a brief review of existing antitrust law insofar as it applies to horizontal and conglomerate mergers is appropriate.

Whereas horizontal mergers involve the joining of firms which produce similar or substitutable products,[63] a conglomerate merger involves no discernible economic relationship between the products of the acquiring and acquired firm. Both types of mergers have long been scrutinized under section 7 of the Clayton Act; horizontal mergers are, by far, the more suspect.

Although mergers have not been proscribed on the basis of size alone, size is a critical factor in determining their potential anticompetitive effects. For horizontal mergers, the inquiry typically focuses on the share of the relevant market controlled by the parties to the acquisition. In this regard, S. 1246's presumption against large horizontal mergers between the oil companies and other large energy producers does not constitute a radical departure from existing antitrust doctrine. Contrastingly, S. 1246's negative view towards conglomerate mergers does connote a significant shift in policy.

In *United States* v. *Columbia Steel Co.*, the Supreme Court set forth the following standard regarding horizontal mergers:

> In determining what constitutes unreasonable restraint, we do not think the dollar volume is in itself of compelling significance; we look rather to the percentage of business controlled, the strength of the remaining competition, whether the action springs from business requirements or purpose to monopolize, the probable development of the industry, consumer demands, and other characteristics of the market. We do not undertake to prescribe any set of percentage figures by which to measure the reasonableness of a corporation's enlargement of its activities by the purchase of assets of a competitor. The relative effect of a percentage command of a market varies with the setting in which the factor is placed.[64]

62 S. 600 Hearings, *supra* note 57, pt. II, at 10 (statement of Prof. Richard A. Posner). Prior to the introduction of S. 1246, Senator Kennedy proposed S. 600, which would have banned mergers between firms having more than $2 billion in annual sales or assets.

63 *See, e.g.*, United States v. E.I. duPont de Nemours & Co., 351 U.S. 377, 404 (1956).

64 334 U.S. 495, 527-28 (1948).

Although *Columbia Steel* was decided under section 1 of the Sherman Act, section 7 of the Clayton Act was soon amended in 1950 to include asset acquisitions. The amended section 7 was first interpreted by the Supreme Court in *Brown Shoe Co.* v. *United States*.[65] There, the Court held that Congress intended to prevent only mergers "having demonstrably anticompetitive effects".[66] Whereas S. 1246 employs quantitative criteria, the Court noted that the congressional deliberations regarding section 7 reflected "a conscious avoidance of exclusively mathematical tests" and that "a merger had to be functionally viewed, in the context of its particular industry."[67]

Whereas *Brown Shoe* rejected any simple, quantitative tests, the Supreme Court in *United States* v. *Philadelphia Nat'l Bank*[68] expressed concern with the "danger of subverting congressional intent by permitting a too-broad economic investigation." The Court then announced a simplified, less factually oriented test of illegality:

> [A] merger which produces a firm controlling an undue percentage share of the relevant market, and results in a significant increase in the concentration of firms in that market is so inherently likely to lessen competition substantially that it must be enjoined in the absence of evidence clearly showing that the merger is not likely to have such anticompetitive effects.[69]

Mergers which threaten market conditions normally associated with free competition are presumptively disfavored.[70] In effect, the simplified test of illegality endorsed by the Court in *Philadelphia Bank* resulted in a de facto shifting of the burden of proof away from the government to the proponents of the merger.

In *United States v. General Dynamics Corp.*,[71] the Court upheld the merger of two leading coal producers. The merger increased the market share of the two largest firms in two geographical markets from 45 to 49 percent and from 44 to 53

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65 370 U.S. 294 (1962).
66 *Id.* at 319–20.
67 *Id.* at 321 n.36, 321–22.
68 374 U.S. 321, 362 (1963).
69 *Id.* at 363.
70 *Id.* at 363.
71 415 U.S. 486 (1974).

percent and occurred against a background of rapid and steep decline in the number of coal producers. Based on earlier decisions,[72] it appeared that the merger clearly violated section 7. Yet, relying on language in *Brown Shoe* asserting that while market-share percentages are "the primary index of market power . . . only a further examination of the particular market — its structure, history and probable future — can provide the appropriate setting for judging the probable anti-competitive effect of the merger," the Court upheld the merger.[73]

Conglomerate mergers having anti-competitive effects are also proscribed by section 7 of the Clayton Act.[74] According to the Federal Trade Commission:

> The necessary proof of violation of the statute consists of types of evidence showing that the acquiring firm possesses significant power in some markets or that its over-all organization gives it a decisive advantage in efficiency over its smaller rivals.[75]

The courts have relied upon several theories to strike down conglomerate mergers with anti-competitive effects; the "elimination of potential competition" theory is perhaps the most relevant to our inquiry. To the extent that a merger may eliminate either the acquiring or acquired company as a potential competitor, the merger may violate the antitrust laws. For example, in *United States* v. *Phillips Petroleum Co.*,[76] the court found objective evidence of resources, opportunity, and motivation to enter a market de novo sufficient to establish that a firm was a significant potential entrant. However, whether the loss of such potential competition is sufficient to sustain a violation of section 7 will depend on the relevant economic context. As the Supreme Court noted in *United States* v. *El Paso Natural Gas Co.*,[77] the competitive significance of acquiring a company not presently in the market is to be "determined by the nature and extent of that market and by the nearness of the

72 *See, e.g.*, United States v. Von's Grocery Co., 384 U.S. 270 (1966).

73 415 U.S. at 498, *quoting* 370 U.S. at 322 n.38.

74 See F.T.C. v. Proctor & Gamble Co., 386 U.S. 568 (1967).

75 Foremost Dairies, Inc., 60 F.T.C. 944, 1084 (1962).

76 1973-2 Trade Cases CCH ¶ 74,789, at 95,518 (C.D. Cal. 1973).

77 376 U.S. 651, 660 (1964). *See also* United States v. Penn-Olin Chemical Co., 378 U.S. 158, 176 (1964).

absorbed company to it, that company's eagerness to enter that market, its resourcefulness and so on."

In *Kennecott Copper Corp.* v. *FTC*,[78] the court prohibited the purchase of a leading coal company by Kennecott because Kennecott was a potential entrant into the coal mining business, and the merger would have significantly increased barriers to entry. The court found that Kennecott, already located in a related industry, had some transferable expertise, had previously expressed an interest in entering the industry, and had large cash reserves which it was looking to invest in just such a venture. Either internal expansion or a "toehold acquisition" would have been a more competitive means of entry.[79] The court also noted that the acquisition would exacerbate a nascent trend toward concentration within the industry.

In *United States* v. *Marine Bancorporation, Inc.*,[80] the Supreme Court held that the potential-competition theory was applicable only to concentrated markets where "there are dominant participants in the target market engaging in interdependent or parallel behavior and with the capacity effectively to determine price and total output of goods and services." A prima facie case for the applicability of the potential-competition theory can be made by demonstrating that the target market is highly concentrated. Evidence of significant market competition can rebut the prima facie case.[81]

According to some critics, the courts have interpreted section 7 of the Clayton Act so as to discourage the extension of superior managerial skill and the resulting productivity gains.[82] These critics maintain that ever since the *Brown Shoe* decision, the courts have been reluctant to judge the appropriateness of a merger by its competitive impact upon particular markets — the alleged intent of the statute.[83] The legislative history of the Clayton Act reveals a congressional concern with the "rising tide of economic concentration" in the American economy.

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78 467 F.2d 67 (10th Cir. 1972), *cert. denied*, 416 U.S. 909 (1974).

79 *Id.* at 77-78 n.8.

80 418 U.S. 602, 630 (1974).

81 *Id.* at 631.

82 *S. 600 Hearings*, *supra* note 57, at 10-15 (statement of Prof. Richard Posner). *See* R. Bork, The Antitrust Paradox: A Policy at War With Itself, chs. 9-12 (1978).

83 R. Bork, *supra* note 82, at 200.

Concentration, it was believed, could result in higher prices by facilitating collusion among sellers in the market; the reduction in the number of firms was thought to endanger the social values associated with the preservation of small firms.[84] The courts have frequently employed this expression of congressional concern to strike down mergers on the basis of other than strict economic criteria. As the Court stated in *Brown Shoe:*

> It is competition, not competitors, which the Act protects. But we cannot fail to recognize Congress' desire to promote competition through the protection of viable, small, locally owned businesses. Congress appreciated that occasional higher costs and prices might result from the maintenance of fragmented industries and markets. It resolved these competing considerations in favor of decentralization.[85]

According to Donald Turner, former head of the Justice Department's Antitrust Division, there is "no credible support for the [above] statement in *Brown Shoe* that Congress resolved the competing considerations in favor of decentralization."[86] Former Solicitor General Robert Bork has also written that "[t]here is no way Clayton 7's criteria about competition in particular lines of commerce can be legitimately invoked to prevent mergers that may increase the total concentration in the American economy but do not threaten competition in any market."[87]

As this brief review of existing antitrust law indicates, some of the same critics who oppose S. 1246 are not particularly pleased with existing case law interpreting section 7. To the extent that the courts have been influenced by social rather than economic considerations and have employed quantitative criteria to shift the burden of proof to the proponents of the merger, existing section 7 law shares certain similarities with S. 1246. While the perpetuation of such pre-existing flaws in interpretation does not make S. 1246 any more acceptable to these critics, it at least places S. 1246 in a somewhat more familiar legal context.

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84 *See, e.g.*, S. REP. No. 1775, 81st Cong., 2d Sess. 3, 5 (1950).

85 370 U.S. at 344.

86 Turner, *Conglomerate Mergers and Section 7 of the Clayton Act*, 78 HARV. L. REV. 1313, 1326 (1965).

87 R. BORK, *supra* note 82, at 203.

V. The Effectiveness of S. 1246's Affirmative Defenses — Enhancing Competition and Promoting Energy

Although critics charge that courts have interpreted the requirements of section 7 too stringently, it remains the case that section 7 of the Clayton Act is directed only at mergers which increase the probability of anti-competitive market behavior. To prevail in a section 7 case, the government must show that the effect of the acquisition "may be substantially to lessen competition." S. 1246, therefore, makes mergers more difficult to accomplish than under existing law. However, mergers that either substantially enhance competition or promote energy activities constitute affirmative defenses under the proposed legislation. The utility of these affirmative defenses is vigorously disputed.

The opponents of S. 1246 claim that it would be excessively difficult to prove enhancement of competition because the inference from concentration to competitive effects would be unavailable to the proponents of the merger.[88] Because mergers do not, by definition, decrease concentration, proponents of the merger would be unable to resort to proof of changes in concentration and "would be left with the much greater burden of showing that a merger would increase output,"[89] in order to successfully interpose the enhancement-of-competition defense.

Similarly, Thomas Kauper, a former head of the Justice Department's Antitrust Division, testified that:

> Given all of the legal uncertainties and the difficulties created by the severe burden of proof, it seems highly unlikely that either of the proposed defenses could be successfully invoked even in cases which would, in the long run, prove to be pro-competitive or pro-energy. Few firms would be prepared to assume the risk, delay and expense [that] reliance on the defenses would impose.[90]

The argument that the courts are ill-suited to determine the putative pro-competitive or pro-energy effects of a proposed merger has frequently been applied to the present section 7. As Donald Turner noted, "[t]aken literally, section 7 asks for a

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88 Minority Rep., *supra* note 11, at 172.

89 *Act Hearings*, *supra* note 30, at 772 (statement of Kenneth W. Dam).

90 *Id.* at 798 (statement of Thomas E. Kauper).

predictive economic judgment, a conclusion as to the probability of various possible economic consequences of a merger, and an assessment of the substantiality of those effects."[91] Economic theory simply is not capable of providing us with any way to make such judgments with requisite certainty. For this reason, Turner believes that it might be preferable to opt for a general prohibitory rule that would reflect a "considered economic judgment that the anticompetitive consequences are more probable than not in the class of cases that it covers."[92]

The opponents of S. 1246 have argued that the pro-competitive or pro-energy defenses established by the legislation would encourage a complicated factual inquiry rejected by the Supreme Court in *Philadelphia Bank.* However, subsequent decisions of the Court seem to endorse detailed analysis of the merger's particular economic setting.[93] Additionally, the continued adherence of the courts to the use of market-share statistics to establish a presumption of illegality perpetuates the de facto shifting of the burden of proof away from the government to the proponents of the merger endorsed by the Court in *Philadelphia Bank.* The proponents of S. 1246 dispute their opponents' contentions that the two affirmative defenses are simply analogous to existing antitrust defenses such as that for the "failing company" and "offsetting benefits" tests used in connection with mergers in regulated industries.[94]

A. *Enhancing Competition*

Mergers which "enhance competition" are permitted under S. 1246. The term "enhance competition" implies a condition which, "on balance, promotes consumer welfare by giving rise to market conditions likely to increase the aggregate value of output to purchasers."[95] This definition of competition as a process of promoting the optimal employment of resources in the production of goods and services reflects the fundamental

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91 Turner, *supra* note 86, at 1318.
92 *Id.* at 1319.
93 *See, e.g.,* United States v. General Dynamics Corp., 415 U.S. 486 (1974).
94 S. REP., *supra* note 5, at 82.
95 *Id.* at 82-83.

purposes of antitrust legislation.[96] If a merger is likely to enhance the aggregate value of output to consumers or bring about the conditions under which such an enhancement might be expected by increasing allocative efficiency, the merger should be permitted.

Under the existing section 7 "incipiency test," the courts are required to predict whether a merger is likely to lessen competition. Mergers which threaten to move markets away from the structural conditions normally associated with free competition are presumptively disfavored.[97]

According to the Committee, mergers most likely to enhance competition fall within two categories: (1) "shakeup" or "rescue" mergers of firms performing at less than their capacity; and (2) mergers generating efficiencies.[98] These defenses have been extensively litigated.[99] Because affirmative defenses are not uncommon in merger law, existing case law should prove useful in defining the meaning and assessing the utility of the enhancing-competition and energy-promotion defenses allowed by S. 1246.

B. *Shakeup or Rescue Mergers*

Although section 7 views with suspicion any merger likely to enhance market power, it does favor acquisitions in concentrated markets which increase the ability of a small or sluggish competitor to compete with larger rivals through a "shaking up" of the existing market structure. Additionally, section 7 recognizes that the acquisition of a firm which is likely to leave the market entirely has positive competitive benefits. These two types of favored mergers are known as "toehold" and "failing-company" acquisitions.

To constitute a permissible "toehold" acquisition, the acquired company should have less than a ten-percent market

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96 *Id.; accord,* United States v. Philadelphia Nat'l Bank, 374 U.S. at 367 n.43; Mantell, *Conglomerate Mergers, Allocative Efficiency, and Section 7 of the Clayton Act,* 56 TEX. L. REV. 207 (1978).

97 *See* United States v. Philadelphia Nat'l Bank, 374 U.S. at 363.

98 S. REP., *supra* note 5, at 84.

99 *See* In re The Budd Co., 86 F.T.C. 518 (1975) (toehold); United States v. M.P.M., Inc., 397 F. Supp. 78 (D. Colo. 1975) (failing company); United States v. Lever Bros. Co., 216 F. Supp. 887 (S.D.N.Y. 1963) (failing company).

share in a highly concentrated market.[100] Toehold rules focus primarily on the deconcentration effect of adding a vigorous and growing company to the list of significant market competitors in a tight oligopoly.[101] In addition to contributing to the long-term deconcentration of the market, a toehold acquisition may enable the acquired firm to develop improved services and more effective marketing techniques, sparking a competitive response by other firms. According to the Committee, "[s]uch competitive benefits derived from toehold acquisitions should be cognizable under the enhancing competition defense."[102]

Although the proponents of S. 1246 cite approvingly to the "toehold defense," noted authorities such as Robert Bork maintain that this defense is contrary to the concept of consumer welfare, an explicit goal of the authors of S. 1246's affirmative defenses. According to Bork, if mergers are motivated by efficiency considerations, an acquiring firm will seek out companies offering the greatest potential. By potentially shifting the acquisition to a less preferred firm, the toehold doctrine decreases the efficiencies which may be realized. As Bork states:

> The toehold theory is necessarily based on the erroneous idea that it is better for consumers to have less efficiency than more, so long as the decreased efficiency goes to smaller rather than larger firms. That is a preference for industrial fragmentation at the expense of consumers. Whatever else it may be, it is not a valid antitrust theory.[103]

C. *Failing-Company Defense*

An otherwise impermissible merger may be approved if it is the only reasonable mechanism available for preventing the failure of one of the merger partners. The failing-company doctrine was first enunciated in *International Shoe Co. v. FTC.*, where the Supreme Court held that the purchase of the stock of a competitor did not offend the Clayton Act because the resources of the acquired company were "so depleted and the prospects

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100 The ten-percent figure is a Justice Department guideline that is not automatically adopted by the courts. S. REP., *supra* note 5, at 84.
101 *Id.*
102 *Id.*
103 R. BORK, *supra* note 82, at 262.

of rehabilitation so remote that it faced the grave possibility of business failure."[104] The Court elaborated upon this doctrine in *Citizen Publishing Co. v. United States,* and added that the acquiring firm must be the only available purchaser.[105] If any other prospective purchaser can be found who would maintain the competitive unit in the marketplace, the acquisition will be prohibited. Emphasizing that the burden of showing the probable failure of the acquired firm rests on "those who seek refuge under the failing company defense,"[106] the Court stated that defendants must show that reorganization under the bankruptcy laws is not feasible, and that the acquired firm has made bona fide efforts to find an alternative purchaser.[107]

Despite the Court's holding in *Citizen Publishing Co.,* subsequent cases suggest that the showing of dim prospects for bankruptcy reorganization is not absolutely essential to a successful assertion of the failing-company defense.[108] In fact, in *United States* v. *General Dynamics Corp.,* the Court held that the dim future of an acquired company may indicate absence of the proscribed effect on competition, thereby making it unnecessary to invoke the failing-company defense.[109]

Conglomerate (as compared to horizontal) mergers are less likely to enhance the market power of the acquiring firm. Under these circumstances, the sponsors of S. 1246 suggest that such mergers would be justified even though the firm is not literally "failing," but is "simply 'stagnant' or competitively moribund."[110] For example, declining market shares or failure to grow in an expanding market could be grounds for permitting the merger. Insofar as horizontal mergers involving failing firms are concerned, such mergers would be permitted as long as they did not lessen competition. "It is the intent of S. 1246 . . . to incorporate entirely the failing-company doctrine of existing section 7 and to permit an acquisition under the 'enhancing

104 280 U.S. 291, 302 (1930).
105 394 U.S. 131, 138-39 (1969).
106 *Id.* at 138-39.
107 *Id.* at 138; *accord,* United States v. Greater Buffalo Press, Inc., 402 U.S. 549 (1971).
108 *E.g.,* United States v. Black and Decker Mfg. Co., 430 F. Supp. 729, 778 (D. Md. 1976).
109 415 U.S. 486, 508 (1974).
110 S. REP., *supra* note 5, at 85.

competition' defense whenever current failing-company standards would be satisfied."[111]

D. *Mergers Generating Efficiencies*

Section 7 does not permit litigants to justify an otherwise unlawful merger on the basis of potential efficiencies or economic savings. Moreover, in *Brown Shoe,* the Supreme Court went so far as to suggest that efficiencies could constitute a positive reason for holding the merger unlawful.[112]

This view reflected the Court's belief that section 7 codified a congressional distrust of substantial market concentration. As discussed in section IV above, Donald Turner and other well known authorities have maintained that the Court's interpretation of the legislative history of section 7 in *Brown Shoe* is "not only bad economics but bad law."[113] According to Turner:

> [T]here seem to be overpowering reasons against using cost savings as a basis for invalidating conglomerate or other mergers. First, there is the enormous social interest in progress and efficiency, which has represented one of the primary bases for the policy of promoting competition as it has in fact evolved. Second, to forbid mergers that would or might produce substantial efficiencies would narrow substantially the category of acceptable mergers, thereby drastically weakening the market for capital assets and seriously depreciating the price that entrepreneurs could get for their businesses when they wish to liquidate. Such a policy would seriously interfere with maximum exploitation of productive resources; and not only might it have adverse long-run effects on entry and growth of small business, but it would also be clearly against the interests of small businesses already in being. . . . Third, the protection that this policy would afford to small business, except in the short run, is at best highly conjectural and probably negligible.[114]

Bork is especially critical of the Court's opinion in *FTC. v. Proctor & Gamble,* in which the Court noted that "[p]ossible economies cannot be used as a defense to illegality — Congress was aware that some mergers which lessen competition may

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111 *Id.*
112 *See* text accompanying notes 65 to 67 *supra.*
113 Turner, *supra* note 86, at 1324.
114 *Id.* at 1326.

also result in economies but it struck the balance in favor of protecting competition."[115] Bork not only denies that Congress struck any such balance, but he also notes that the "statement that efficiency is not relevant means that consumer welfare is not important, and that in turn means that the primary reason for preserving competition is to be disregarded."[116]

The notion that the realization of significant economies should not constitute an affirmative reason for invalidating a merger does not imply that economies should represent a valid defense to an otherwise illegal merger. Efficiencies or economies are appropriate factors to be weighed against possible anti-competitive effects of a merger; efficiency-creating mergers may be pro-competitive in the sense that they promote entry by providing a less costly means for a firm to enter as well as applying pressure on other firms to improve their economic performance.[117]

Whether conglomerate mergers are likely to yield substantial economies is a controversial question:

> Of all types of merger activity conglomerate acquisitions have the least claim to promoting efficiency in the economic sense. The lower costs that might result in a horizontal acquisition from the pooling of skills and know-how gained in the production of the same product from different facilities are absent. Likewise the conglomerate acquisition affords little opportunity for the closing down of the less efficient facilities and the centralization of production in the more efficient. Similarly, the gains in a vertical acquisition which might result from the more logical and orderly arrangement of facilities employed in the successive stages of a continuous production process are not present. Because what is involved is the production of unrelated products the conglomerate acquisition provides few opportunities for the securing of economic efficiency in such matters as specialization as between plants, exchange of cost information between plants, savings in handling and reheating, operating with smaller inventories, reductions in the number of styles and sizes, savings in cross freight, etc.[118]

Other observers take the opposite view and note the advantages which may result from a conglomerate merger:

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115 386 U.S. 568, 580.

116 R. BORK, *supra* note 82, at 204.

117 *See* Turner, *supra* note 86, at 1328.

118 Blair, *The Conglomerate Merger in Economics and Law*, 46 GEO. L.J. 672, 679-80 (1958).

> Both integration and diversification merely represent attempts to move toward the optimum of utilization.
>
> . . . Thus a concern may branch out into new locations or new products because part of what it takes to do the new job is already on hand. This may include fixed capital, research facilities, by-products, engineering know-how, the possibility of spreading a brand name, or the marketing advantages achieved by carrying a 'full line.'
>
> Some advantages, however, are not directly related to spreading overhead. For example, there may be a desire to spread the risk over more sources of income. Again, the establishment of several complementary plants may permit greater specialization of each; contrariwise, another firm may set up similar or identical plants in various locations to avoid hauling.[119]

It is undoubtedly true that economies are less likely to be realized in a "pure" conglomerate merger which produces few economic interrelationships between the products of the acquiring and acquired firms. Nevertheless, economies in management services, advertising costs, and capital costs may result. It should be noted, however, that the greater the difference in product line between the firms, the less likely that the merger will lead to more efficient management. As a result, a firm frequently attempts to acquire a concern whose operations are somewhat familiar to it.

The divergence over the potential efficiencies arising from conglomerate mergers has led many observers to repudiate this factor as a defense, especially in those circumstances where the potential danger of anti-competitive consequences warrants a rule of presumptive illegality. As Carl Kaysen has stated:

> Judgments about efficiency are notoriously difficult . . . and nowhere more so than in respect to the economies of unified ownership of several different technical units operating in different, though related markets. There is every reason to avoid — if at all possible — giving courts the task of determining which of the mergers falling in our general description, are and which are not justified on efficiency grounds, since this is a task to which the trial process is singularly ill-suited.[120]

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119 Adelman, *Integration and Antitrust Policy*, 63 HARV. L. REV. 27, 28 (1949).

120 Turner, *supra* note 86, at 1331 *quoting* C. KAYSEN, THE NEW COMPETITION AND THE OLD REGULATION 25 (to be published by the Wharton School of the University of Pennsylvania).

Similarly, Robert Bork questions efficiency defenses because efficiencies cannot be quantified, and the size of the losses incurred through a projected dissolution cannot be proved:

> Suppose that a merger is proposed and the government seeks to prevent its consummation. In order to explore the trade-off problem by direct study, trial would have to be had on the present contribution of the two firms to consumer welfare; their level of efficiency as separate firms, and the degree, if any, to which they were presently able to restrict output, . . . trial would then have to proceed to the measurement of efficiency and restriction of output under an imaginary set of conditions: what would the net contribution to consumer welfare be if the two firms were merged into one? Judgment would be rendered according to a comparison of the two situations.
>
> Passably accurate measurement of the actual situation is not even a theoretical possibility; much less is there any hope of arriving at a correct estimate of the hypothetical situation.[121]

Although measuring the economies of scale created by a merger can be accomplished by evaluating the post-merger performance of the new entity, an affirmative defense which relies on estimates of a merger's cost savings involves considerable uncertainty. For example, Professor Posner rejects a generalized defense of efficiency, not only because the measurement of efficiency requires a determination as to how soon the efficiencies might be realized without a merger, but also because an estimate of cost savings could not be utilized in determining the merger's total effect unless it also included an evaluation of its monopoly costs.[122] Posner argues that we simply do not know enough about the effects of marginal increases in the concentration ratio under different market conditions to predict the monopoly costs of a challenged merger as compared to its projected cost savings. In commenting on S. 1246's approach, Posner noted that "[t]he worst approach, which is the approach taken by the proposed legislation, would be to broaden the scope of prohibition and couple that step with making provision for an efficiencies defense that is unlikely to prove administrable."[123]

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121 R. BORK, *supra* note 82, at 125.
122 *S. 600 Hearings*, *supra* note 57, at 12 (Statement of Prof. Richard A. Posner).
123 *Id.*

In response to the practical problems encountered in measuring economies raised by the opponents of S. 1246, Bork has commented that "[t]o dismiss an economies defense on the prevailing state of the art is to employ an unacceptably narrow horizon."[124] According to Professor Mueller of the University of Maryland, the economic rationale of the antitrust laws is based on the assumption that if managers maximize profits, the most efficient allocation of resources is achieved through the independently determined prices of each firm.[125] Governmental intervention is warranted only to prevent collusion or other efforts to monopolize. This rationale breaks down when one allows for other than profit-maximizing activities on the part of managers. This is especially true if one accepts the premise that pursuit of growth via merger is conducted at the expense of internal growth and allocative efficiency. Based on this argument, Mueller suggests abandonment of the traditional competition-oriented approach of section 7 and the development of a new policy which would ban all mergers above a given size subject to an efficiencies defense. This efficiency defense would explicitly include replacement-of-bad-management, rescue-of-failing-firms, and capital-transfer efficiencies. The major difference between this approach and existing law would be a shifting of the burden of proof from the government to the proponents of the merger and an emphasis on the potential efficiencies rather than competitive effects of the proposed merger.[126]

Clearly, the appropriateness of an efficiency defense is a highly controversial matter. Consequently, S. 1246 does not attempt to alter existing section 7 case law regarding its treatment. The Committee does state, however, that a demonstration of increased efficiency may be relevant in demonstrating that the proposed acquisition is likely to enhance competition.[127]

To prevail on the basis of increased efficiency, the acquisition proponents will have to demonstrate that "the benefits of the efficiencies will normally be reflected in the form of greater price or quality competition."[128] This means that only those

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124 R. BORK, *supra* note 82, at 127, *quoting* WILLIAMSON, MARKETS AND HIERARCHIES; ANALYSIS and ANTITRUST IMPLICATIONS (1975).

125 Mueller, *The Effects of Conglomerate Mergers: A Survey of the Empirical Evidence,* 1 J. BANKING AND FINANCE 315, 342-43 (1977).

126 *Id.*

127 S. REP., *supra* note 5, at 85-87.

128 *Id.* at 86.

savings entailing a net reduction in the cost to society of producing or distributing goods will be recognized; those reflecting a mere transfer of income would not be considered. These savings are technically known as "non-welfare" or "pecuniary" economies which entail no corresponding economies in the use of real resources. In particular, the non-welfare economies which would be excluded from consideration are those that accrue to a firm through increased bargaining power and tax or accounting savings.

Where the cost savings possess characteristics of both real and pecuniary economies, S. 1246 requires that a distinction be made between these two elements for purposes of administering the enhancing-competition defense. Whether it is practicable to make such distinctions seems open to question. Nonetheless, the Committee adopted the view of Professor Blake of Columbia University Law School:

> The proponent will not meet his burden of proof with complex and diffuse efficiency claims, but only by analysis of industry structure and the posture of the firm to be acquired in the industry, and with a specific showing of technological innovation. These are much simpler factual questions to deal with than those related to generalized efficiency claims. Furthermore, detailed market definitions will not usually be required. Where these factors cannot be shown, the defense may be quickly disallowed. . . .[129]

E. *Promoting Energy*

The final affirmative defense contained in S. 1246 relates to acquisitions that would have the likely effect of materially or substantially promoting "energy exploration, extraction, production, or conversion." In part, this defense protects acquisitions which enhance the overseas production of energy; the benefits of such production should increase the amount of petroleum available for import into the American market.

Of all the available affirmative defenses, this particular provision seems to be the most straightforward. Indeed, if the testimony of oil, coal, and uranium company representatives is accurate, acquisitions by petroleum companies of alternative

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129 *Committee Hearings, supra* note 54, at 815 (statement of Prof. Harlan M. Blake).

energy resources has had a demonstrably beneficial effect, resulting in increased investment and production. To bolster its position, an oil company could submit evidence as to its future production targets and investment plans as well as data relating to the transferability of its existing technology to the acquired company. In fact, the oil companies have submitted such evidence in support of proposed energy-related acquisitions in the past and could be expected to do so in the future.[130]

F. *Substantiality*

In order to justify a proposed acquisition, its proponents must demonstrate that the merger will "substantially" enhance competition or promote energy. According to the Committee, inherent in S. 1246's consumer-welfare approach and the use of the word "substantially" is the "necessity of assessing a merger's net effects by weighing its possible costs and benefits against each other."[131] If the merger is found, on balance, to enhance competition or promote energy, the next step is to determine whether that effect is substantial or material. The Committee Report states that "the benefits of a proposed merger must be substantial in two ways: in terms of the particular market involved, and in comparison to the size of the merger itself."[132]

The former requirement is analogous to section 7's stipulation that the plaintiff must show more than a de minimus potential adverse effect on competition. Similarly, according to the proponents of S. 1246, the likely benefits of the merger must constitute more than a de minimus enhancement of competition. Unlike the former, the latter requirement marks a considerable departure from existing section 7 law in which the percentage of the merging parties' affected business has little significance.[133] This proportionality test is intended to avoid encouraging increases in concentration because "the larger the acquisition the

130 *Act Hearings*, *supra* note 30, at 265 (statement of George T. Piercy, Senior Vice-President and Director, Exxon Corporation).

131 S. REP., *supra* note 5, at 88.

132 *Id.*

133 *See* Chemetron Corp. v. Crane Co., 1977-2 Trade Cases (CCH) ¶ 61,717 (N.D. Ill. 1977).

more extensive must be the necessary enhancement of competition or promotion of energy."[134]

The Committee noted that the "mere existence of a theoretical alternative to a merger that would achieve the same benefit need not operate as an absolute bar."[135] For example, even though the same economies could be achieved through internal expansion, the delays or related expenses which this might entail should be considered in evaluating the merger. The feasibility of an alternative to the merger is not to be considered as a separate test for approval but rather as part of the overall analysis of the merger's legality. It appears appropriate to inquire whether, but for the merger, the parties would achieve the asserted efficiencies or energy promotion within a reasonable period of time.

G. *Probability of Competitive or Pro-Energy Impact*

S. 1246's affirmative defenses also require that the probable effect of the merger would be the substantial enhancement of competition or promotion of energy. Unlike section 7's "may be" language, which has been interpreted as requiring a reasonable probability of the requisite effect proven by a preponderance of the evidence, S. 1246 introduces a stricter standard requiring the establishment of the beneficial effect with a fair degree of certainty. Under section 7's incipiency test, an assessment or prediction of the future effect of the proposed transaction is required. Under S. 1246 a similar predictive assessment would be made:

> Weighing the relative pro- and anti-competitive effects is . . . not foreign to present Clayton 7 analysis. The very language of the statute — requiring a 'reasonable probability of a substantial lessening of competition' — must involve this calculus. Similar determinations must be made by a court in applying the failing company defense. Thus, the courts would not be writing on a tabula rosa in weighing these factors under the proposed statute.[136]

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134 S. REP., *supra* note 5, at 89.
135 *Id.*
136 *Committee Hearings, supra* note 54, at 812 (statement of Joseph B. Bauer).

The contention of S. 1246's opponents that the shifting of the burden of proof and the insertion of the "likely effect would be" language makes the affirmative defenses completely illusory seems unfounded. Indeed, past experience indicates that these defenses are manageable. However, it cannot be denied that the new standard established under S. 1246 will create new problems, albeit not insurmountable ones, for merger proponents.

VI. The Pros and Cons of Conglomerate Mergers

A. *The Negative View of Conglomerate Mergers*

The legislative sponsors of S. 1246 view large corporate mergers or acquisitions with considerable skepticism. According to Senator Kennedy, the conglomerate mergers which are targeted for closer scrutiny by S. 1246

> serve no purpose other than to bring completely unrelated activities together under one management. These mergers add nothing to the economy. They add nothing to the production of energy. They add nothing to our producing capability in any other industry. They create no new assets. They create no new jobs. What they do create is bureaucracy — corporate bureaucracy.
>
> These mergers are simply vehicles for senseless corporate aggrandizement. The growth of corporate bureaucracy for its own sake is as undefensible as the growth of government bureaucracy.[137]

Opponents of the bill maintain that diversification by the major oil companies minimizes the risks inherent in the petroleum industry, thereby enabling the oil companies to pursue otherwise prohibitively risky exploration, research, and development. For this and other reasons, leading authorities such as Donald Turner argue that an outright congressional ban of mergers would be a mistake:

> Widespread prohibition of mergers would impose serious, if not intolerable, burdens upon owners of businesses who wish to liquidate their holdings for irreproachable personal reasons. Moreover, economic welfare is significantly served

137 *Kennedy Remarks*, *supra* note 43.

> by maintaining a good market for capital assets. By enhancing the value of assets when owners wish to sell, a strong capital assets market increases the rewards of successful entrepreneurial endeavor. In this way the possibility of mergers stimulates the formation and growth of new firms, . . . More importantly, a policy of free transferability of capital assets tends to put them in the hands of those who will use them to their utmost economic advantage, thus tending to maximize society's total output of goods and services.[138]

Turner also notes that mergers often yield substantial economies of scale, promote efficient economic performance and enable a business to stabilize its profits by acquiring a diversified line of business.[139]

Two conflicting theories regarding mergers have been formulated: the "neoclassical" theory, which emphasizes the generation of profits, and the "managerial" theory, which stresses the pursuit of objectives by managers other than profit maximization.[140] Among the financial benefits accruing from mergers, the neoclassicist school cites certain tax advantages, increased leverage, diversification, replacement of incompetent management, and redeployment of corporate capital. The proponents of the managerial thesis argue that mergers are pursued by managers for the sake of growth, as opposed to profit maximization.

The economic efficiency and performance of conglomerate firms are subjects of intense debate. Mergers often result in no net gain to the acquiring firm's stockholders; frequently, an acquiring firm must pay a large premium to the stockholders of the acquired firm. Merger critics cite both acquisitions undertaken without clear shareholder benefits and attempts by managers of target firms to resist takeovers to support the managerial thesis that managers pursue corporate growth for objectives other than stockholder welfare and economic efficiency.[141]

The Committee agreed with the argument that conglomerate mergers do not usually generate any new economic benefits. As John Kenneth Galbraith wrote Senator Kennedy, "[t]here is not the slightest proof that the acquisition of two hitherto

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138 Turner, *supra* note 86, at 1317.
139 *Id.*
140 Mueller, *supra* note 125, at 316-18.
141 *See* Mueller, *supra* note 125.

independent firms by a large conglomerate approves [sic] their efficiency, earnings or innovative capacity."[142] Mergers between firms in unrelated industries generally add nothing to the productivity of either firm or the combined operation but rather "serve primarily to centralize control of two independently viable firms under a single corporate umbrella."[143] According to a Justice Department study of conglomerate mergers "the available evidence indicates . . . that conglomerate mergers do not promote the combining firms' productivity. A conglomerate combination does not inherently achieve economies of scale or permit more efficient production of an end product."[144]

The Committee also distinguishes between real economic benefits and improvements in the conglomerate's balance sheet or stock performance. As Alfred Dougherty, Director of the Bureau of Competition of the FTC, testified:

> That is not to say that we fail to recognize the possibility, despite the absence of any 'real' synergies, that tax laws, accounting rules, stock market institutions, and investor psychology may singly or jointly lead the market to prefer the shares of the merged companies over an appropriate portfolio of the premerger stocks. We recognize, for example, that merger may allow an immediate recognition for tax purposes of operating and asset loss, foreign tax and other varieties of carryovers which might otherwise have to be deferred or foregone.[145]

Mergers have not been shown to be superior to internal expansion in achieving potential efficiencies. On the average, profit and return-on-equity data indicate that no efficiency gains are realized by the market during the first few years following the merger.[146] The Committee cites evidence that conglomerate mergers may actually be detrimental to business performance.[147]

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142 Letter from John Kenneth Galbraith to Senator Edward M. Kennedy (July 24, 1979), *reprinted in* S. REP., *supra* note 5, at 61.

143 S. REP., *supra* note 5, at 61.

144 JUSTICE DEPARTMENT, CONGLOMERATE MERGERS, SMALL BUSINESS, AND THE SCOPE OF ANTIMERGER STATUTES 5 (1979) *quoted in* S. REP., *supra* note 5, at 61.

145 *S. 600 Hearings, supra* note 57, at 168 (statement of Alfred Dougherty, Director, Bureau of Competition, FTC).

146 *Mueller, supra* note 125, at 343.

147 S. REP., *supra* note 5, at 53, 61-63. The supporters of S. 1246 argue that diversification can actually damage a firm's ability to raise capital. For example, in 1978, Mobil's energy and chemical business earned a 13.1 percent return on equity compared with 9.3 percent and 2.4 percent for its two subsidiaries, Montgomery Ward and Container Corporation. Since Mobil has acquired these two companies, it has only achieved an AA credit rating.

S. 1246's proponents argue that the pursuit of growth via external expansion comes at the expense of more socially productive forms of growth. Moreover, they claim that mergers compete directly with capital investment, research and development, and other investment expenditures for available cash flows and managerial attention. The Committee also remains dubious of the assertion that mergers provide a mechanism by which efficient management can replace inefficient corporate leadership. Indeed, the evidence frequently indicates that acquiring firms prefer companies possessing high quality management and expertise.[148]

Diversification represents an important aspect of conglomerate merger activity. Where a firm seeks to diversify its operations, "[a]nalysis of the backgrounds and acquisition histories of the conglomerate firms suggests that they were diversifying defensively to avoid (1) sales and profit instability, (2) adverse growth developments, (3) adverse competitive shifts, (4) technological obsolescence, and (5) increased uncertainties associated with their industries."[149]

While diversification seems to be a logical risk-minimizing activity, it is argued that conglomerate mergers do not achieve this goal. For instance, to embark on a series of acquisitions, an acquiring firm must frequently increase its leveraging. "While diversification reduces a company's risk against a downturn for any single line of activity, increased leverage by increasing fixed interest payments increases a company's risk in the face of a general downturn in economic activity."[150] The benefit of diversification as a risk-reducing activity is an empirical question. Although arguments have been presented on both sides, opponents of S. 1246 continue to justify oil company acquisitions or diversification on a risk-reducing basis.

B. *The Positive View of Conglomerate Mergers*

The opponents of anti-merger legislation contest the assertion that because acquiring firms do not always experience substan-

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148 FTC STAFF REPORT: CONGLOMERATE MERGER PERFORMANCE: A FINANCIAL ANALYSIS OF NINE CORPORATIONS, 57-63, 196 (1972) *cited in* S. REP., *supra* note 5, at 63.

149 Weston & Mansinghka, *Tests of the Efficiency Performance in Conglomerate Firms*, 26. J. FINANCE 919, 928 (1971), *quoted in* Mueller, *supra* note 125, at 321.

150 Mueller, *supra* note 125, at 322.

tial increases in either profits or market shares subsequent to acquisitions, conglomerates are economically inefficient. The large premiums which acquiring firms must pay for the companies they acquire (15 to 20 percent above market price on average) mean that unless mergers were efficiency-producing, acquiring firms would incur substantial losses. Efficiencies approximating the premium must be achieved for the acquiring firm to break even.[151] That acquiring firms continue to earn rates of return which approximate the average returns for their industrial group, notwithstanding the payment of substantial premiums, justifies the acquisitions on efficiency grounds. While frequently the acquiring firm's stockholders receive a very small financial gain, if any, from the merger, it is argued that the acquired firm gains significantly from the acquisition.

Another analytic error alleged by opponents of anti-merger legislation is that capital is wasted by conglomerate mergers instead of being utilized for capital investment. Opponents claim that conglomerate mergers affect only the *location* of savings, and do not decrease the aggregate savings available for capital investment. Professor Baxter has noted that while savings may change hands, the aggregate potential for investment remains essentially unaltered because transaction costs in acquisitions between substantial companies are relatively small.[152] Of course, the issue that is at the heart of the S. 1246 debate is the location of savings and the desire to prevent their relocation outside of the petroleum industry.

Because acquired firms seem to benefit from acquisitions, "the merger market is an important device for disciplining incompetent management and for moving assets out of the hands of such managers and into the hands of more efficient ones."[153] Pro-merger forces maintain that the more productive use of the acquired assets by superior management benefits society as a whole. Conglomerates internalize the markets for capital and technological know-how. According to Professor Teece, an assessment of the efficiency properties of conglomerate and laterally integrated firms must begin with an assessment of the relative efficiencies associated with internal organization as

151 *S. 600 Hearings, supra* note 57, at 16-17 (statement of Prof. Richard A. Posner).
152 *Act Hearings, supra note* 30, at 466 (statement of Prof. William F. Baxter).
153 *S. 600 Hearings, supra* note 57, at 15 (statement of Prof. Richard A. Posner).

compared with market organizations.[154] At issue is whether managers can improve upon market outcome by internalizing certain functions.

By definition, a pure conglomerate is not able to transfer common technology or know-how to its component parts. However, a pure conglomerate can internalize various capital-market functions which will enhance overall economic efficiency. Before a firm can have access to external funds to finance investments, prospective investors need to be apprised of information relating to the risk of the project, creditworthiness of the borrower, etc. This involves transaction costs which are not present when a firm relies on internal financing. According to Teece, "[t]he potential for increased efficiency through conglomerate diversification lies in the effective utilization of the firm's internal capital market. . . ."[155]

To the extent that a conglomerate possesses greater financial resources than a single-purpose firm, Teece is correct in asserting that many capital-market functions can be internalized. However, there seems to be no guarantee that internal financing will necessarily lead to greater economic efficiency. For example, the scrutiny applied to proposed investment schemes by disinterested outside lenders can help ensure that the proposed investment is an economically viable one. An efficient, profit-maximizing energy firm would undoubtedly insist that in-house proponents of a particular investment scheme provide the same justification and support as required by outside lenders before embarking on the venture. To the extent that such in-house scrutiny is lacking, internal financing may actually lead to a more inefficient allocation of resources than would be the case if external financing were utilized. Teece recognizes this problem by stating that in order for conglomerates to realize these efficiencies, there must be "an organizational structure which facilitates the internal competition for capital and provides for its allocation according to objective criteria."[156]

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154 *Act Hearings*, *supra* note 30, at 137 (statement of Prof. David J. Teece).

155 *Id.* at 142.

156 *Id.* at 142-43. Teece admits that the empirical studies of conglomerate firm performance have not made the organizational form distinctions which underlie his basic thesis. While conclusions based on these same "inadequate" studies that conglomerates are inefficient may be attacked on this basis, so too can Teece's conclusions to the contrary.

Whether oil companies possess the requisite organizational structure to benefit from these potential efficiencies is unclear. Teece maintains that "all the major petroleum companies do possess the appropriate internal structures" to capture potential capital market efficiencies, *i.e.*, a divisionalized structure in which operating and strategy decision-making is clearly separated.[157] The group responsible for the latter monitors the performance of the former.

The large petroleum companies are organized so as to require competition for cash among the various divisions. This internal allocation of capital reduces the possibility that high-yield investments will be rejected even if the particular division's internal cash flow falls short of investment requirements. This results because corporate executives within a single organization will possess superior information to assess investment proposals as well as less incentive to distort information to attract funds. "[O]pportunism is attenuated since divisional managers are less able to appropriate the potential gains which may result from the deliberate distortion of the information supplied to capital suppliers."[158] Additionally, the costs of floating new debt and equity issues are avoided with internal financing.

Teece may be correct in claiming that internal financing reduces or attenuates "opportunism" to attract capital funds. However, strong sanctions can be brought to bear upon promoters who employ false or misleading statements when soliciting funds in the capital markets. Consequently, it is equally plausible to state that although the rewards of "opportunism" are greater with external financing, so too are the risks.

The proponents of S. 1246 have also expressed the concern that these mergers and acquisitions have a deleterious impact on technological innovation. They contend that growth through merger and acquisition creates large bureaucracies which impede technological innovation. Based upon his study of firm performance in the petroleum industry, Teece concludes that the opposite in fact is true: "The largest eight petroleum firms (ranked by assets) accounted for 74.9 percent of the industry's total R&D in 1975."[159] He claims that an analysis of the major in-

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157 *Id.* at 143.
158 *Id.* at 144.
159 *Id.* at 148. As Teece suggests, though, "R&D expenditures are an imperfect

novations in the petroleum industry which have been commercialized as of July 1, 1976, "suggests the unchallenged innovational preeminence of the top 20 firms."[160]

Teece's arguments appear to have a solid foundation insofar as they concern the relationship between firm size and technological innovation. However, the evidence presented pertains most directly to lateral, not conglomerate, innovations. There is no evidence which would support a conclusion that diversification of petroleum companies into totally unrelated product lines produces the same innovative preeminence. However, to the extent that technological innovation depends on the financial strength of the firm in question, size alone would appear to be a highly relevant factor.

VII. The Pros and Cons of Horizontal Mergers in the Energy Industry

A. *The Benefits of Lateral Acquisitions*

The potential gains from expansion into related product lines where production and distribution activities depend on common technologies are more discernible than those arising from conglomerates. For the major oil companies, lateral acquisitions frequently include diversification into coal, uranium, or other energy resources. According to George Shultz, the prohibition of such acquisitions by large oil companies would slow the pace of innovation and the application of new technology to the energy industry because:

> 1. These [oil] companies have a superior track record of research, innovation, and commercialization of new technologies on a large scale.
> 2. The results of this research have applicability far beyond the oil and gas industry itself.
> 3. The transfer of technology through acquisition sometimes can be the method that provides the quickest, the surest, and the most complete use of the technical development and expertise involved.[161]

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proxy for technological progressiveness. The object of an R&D program should be not to spend dollars but to produce commercially viable innovations." *Id.*

160 *Id.* at 149.

161 *Act Hearings, supra* note 30, at 579 (statement of George P. Shultz).

Lateral acquisitions are viewed as more efficient vehicles for technology transfer than the sale or licensing of such knowledge in the market place.[162] Research and development projects are, of necessity, shrouded in secrecy. Yet, for markets to work efficiently, potential buyers must possess adequate information. Even if the secrecy problems inherent in technology transfer could be overcome, license agreements for the sale of proprietary technological know-how are difficult to arrange and enforce, especially prior to commercialization. Such arrangements are also likely to be inadequate because the sale of technology under license seldom yields a return equivalent to that which can be obtained through internal ownership.[163] To the extent that a firm is laterally integrated, these problems of technology transfer may be avoided.

Some critics of S. 1246 claim that the highly uncertain outlook for foreign operations and the combination of low returns and increasingly complex governmental regulation of domestic oil have made diversification absolutely necessary. This argument holds that the oil companies must be free to expand into other fields as part of an endeavor to cope with declining oil production in the United States and the world, and thereby, to assure their continued vitality.[164]

Professor Baxter has pointed out that "[d]iversification through merger is a device for, among other things, reducing the aggregate level of risk [and hence cost] that an enterprise faces."[165] Insofar as the oil industry is concerned:

> The risks facing the oil industry are in many respects greater than the risks facing other industries. . . . the needs of the oil companies to do long-range strategic planning are as great or greater than in other industries. Once this need is recognized then the general economic functions of mergers in company long-range planning apply.[166]

Finally, supporters of lateral acquisitions maintain that the oil companies possess technology which is directly relevant to

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162 *Id.* at 138-39 (statement of Prof. David J. Teece).

163 Teece, *Horizontal Integration in Energy: Organizational and Technological Considerations* in HORIZONTAL DIVESTITURE 42 (W. Moore ed. 1977).

164 *Act Hearings, supra* note 30, at 608 (statement of Howard W. Blauvelt).

165 *Id.* at 407 (statement of Prof. William F. Baxter).

166 *Id.* at 68 (statement of J. Fred Weston).

the development of alternative energy resources. Lateral acquisitions enable these companies to realize considerable savings in the transfer of expertise. Indeed, the expensive research facilities required to engage in high-risk alternative energy projects often makes "sense only as part of a diversified portfolio of research activities."[167] Impeding the transfer of such technology by barring acquisitions or mergers by the major oil companies could hinder the development of alternative energy sources.

B. *The Dangers of Lateral Acquisitions*

Despite acknowledgement by the proponents of S. 1246 that the major petroleum companies have developed an impressive level of technological expertise and have the ability to raise the enormous amounts of capital necessary for the development of alternative energy resources, they believe that small acquisitions are more likely to achieve economies in management, research, technology, and capital. While admitting that these economies may justify toehold acquisitions or acquisitions of ill-managed companies, the Committee claims that such efficiencies fall off at the level of acquisition which is targeted by S. 1246. According to the Committee, S. 1246 prevents mergers in which a presumption is warranted that there are no significant economies to be gained: "a level at which the acquired company is big enough to support the best technology, to finance R & D, to hire the best managers, and to acquire capital on the best terms."[168]

De novo investment or entry, it is argued, is always preferable to large acquisitions, because, unlike acquisitions, investment and entry produces jobs, capital formation, and economic growth. Prohibiting horizontal mergers forces an oil company anxious to capitalize on its expertise to either license that technology or enter the market independently. Either route, it is argued, provides more competition in the industry.[169] The Committee views horizontal integration of the energy industry with

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167 Teece, *supra* note 163, at 41.

168 S. Rep., *supra* note 5, at 55.

169 *Act Hearings*, *supra* note 30, at 264 (statement of B. Charles Ames).

suspicion because oil firms that are engaged in multidimensional operations are unlikely to "undermine their stake in depletable oil and gas resources — the value and profitability of which are enhanced by their progressive scarcity — by investing the huge sums required to promote the rapid development of economically viable substitutes."[170] Critics question whether horizontal diversification of the oil companies will reduce the present competition on the market between oil, coal, natural gas, and uranium. The increased use of gasification and liquification techniques will make coal a more viable alternative in the transportation sector, a major energy consumer. Suspicions surround the effect of horizontal diversification on inter-fuel competition. According to the theory known as "integrated firm withholding":

> The large oil companies have very substantial fixed investments in the oil and gas markets. If these companies control substantial amounts of substitute fuels, and they act in their rational self-interest, they may slow the pace of production of the alternative fuels in order to protect the value of their oil and gas reserves. Any decision an oil company makes concerning the production or development of substitute fuels would logically take into account its effect on the value of the company's existing oil and gas reserves and related capital assets. The result is what we will call integrated firm withholding, a term with both extractive and technological aspects.[171]

Withholding by a horizontally integrated energy company could take place through: (1) a slower rate of development of reserves; (2) a slower rate of extraction once reserves are developed; (3) a slower rate of development of alternative fuel technologies; or (4) a slower rate of commercial introduction of such technologies.[172] However, withholding would only occur if an alternative fuel is currently or is expected to be a substitute for oil in the future. For this reason, it would be particularly

170 Adams, *Horizontal Divestiture in the Petroleum Industry: An Affirmative Case*, in HORIZONTAL DIVESTITURE 13 (W. Moore ed. 1977).

171 *Act Hearings*, *supra* note 30, at 245 (statement of Alfred Dougherty).

172 *Horizontal Divestiture: Joint Hearing Before the Subcomm. on Antitrust and Monopoly of the Senate Comm. on the Judiciary and the Subcomm. on Energy and the Environment of the House Comm. on the Interior*, 95th Cong., 2d Sess. 87-89 (1978) [hereinafter cited as *1978 Joint Hearing*] (document submitted by Bureau of Competition, Federal Trade Commission, entitled "Competitive Implications of Oil Company Involvement in Alternative Fuels" [hereinafter cited as "Competitive Implications"]).

advantageous for an oil company to retard the introduction of technological advances which increase the degree of substitutability, and hence competition, between fuels.[173] The Committee believes that the history of the development of synthetic fuels suggests that oil companies may not be pressing forward as quickly as is feasible in this area due to their large investments in conventional petroleum operations.[174]

While withholding is not likely to become a reality under present market conditions, the future expansion of the oil companies into alternative fuels could result in such an eventuality. Yet, why act legislatively if withholding is at present only a theoretical possibility? According to Alfred Dougherty of the FTC, "the maintenance and promotion of interfuel competition is too important to run a significant risk of this kind of integrated firm withholding behavior."[175]

C. *The Likelihood of "Integrated Firm Withholding"*

Two factors are necessary for withholding: strong interfuel substitution and monopoly power in the energy market.[176] The existence of separate energy markets limits the number of customers who can choose among fuels. Fuel substitution in transportation is virtually non-existent.[177] Interfuel substitution is most pronounced in the generation of electricity, where coal, oil, and uranium compete directly at the plant-design stage for use as the utility fuel.[178] Electric generation, either through coal or uranium, also competes indirectly with oil and natural gas in the home-heating market.[179] Even in electric generation, however, substitution is limited, because once constructed, plants are wedded to the use of the fuel for which they were designed.[180] The potential for substantial interfuel substitution in

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173 *Id.*
174 S. Rep., *supra* note 5, at 39.
175 *Act Hearings, supra* note 30, at 245 (statement of Alfred Dougherty).
176 *Id.* at 45 (statement of Prof. David J. Teece).
177 *1978 Joint Hearings, supra* note 172, at 82.
178 *Id.* at 84.
179 *Id.* at 83.
180 *Horizontal Integration of the Energy Industry: Hearings Before the Subcomm. on Energy of the Joint Economic Comm.*, 94th Cong., 1st Sess. 47-48 (1976) [hereinafter cited as *Economic Hearings*] (statement of C. Howard Hardesty, Jr.).

the future is the real cause for concern about the cross-ownership of fuels.[181] For example, introduction of a commercially viable fuel synthesized from coal could greatly increase interfuel competition, especially in the transportation market, which accounts for 50 percent of all oil consumption.[182]

Although the issue of monopoly power in the general energy market is hotly disputed, it appears that healthy competition is certainly lacking within the oil industry itself. Although market-concentration measures are often useful in assessing the competitive structure of an industry, the predominance of joint ventures in the oil industry renders concentration ratios inadequate:

> The problem is that the firms entering the industry are, first of all, partners. They are not independent corporate entities. They have a very large proportion of their interests in all of their enterprise areas tied up in each other's hip pockets. Each of these firms, with the exception of Exxon, owns the majority of their producing oil and gas wells jointly with other firms in the petroleum industry. Exxon's percentage is . . . between 45 and 50 percent.[183]

As a result, the oil companies do not behave competitively "in the classic sense of firms fighting each other at arms length for their share in a fuel market."[184] Rather, "[c]ooperative arrangements and interdependence among dominant firms within the group guarantee that the intramural scuffling for a larger share of the combination's market does not erupt into the full-fledged price cutting and arms-length bargaining that would threaten the system's stability."[185] As Frederick Scherer has noted, the extensive use of joint ventures in the energy field leads to a "cooperative spirit which would not exist if the companies were independent."[186]

Although commentators disagree about whether statistics on oil and gas company holdings in the uranium and coal industries indicate monopoly control, the weight of authority is against

181 *Id.*

182 *Joint Hearings, supra* note 172, at 52 (statement of Alfred Dougherty).

183 *Economic Hearings, supra* note 180, at 18 (statement of John W. Wilson).

184 SENATE COMM. ON THE JUDICIARY, PETROLEUM INDUSTRY COMPETITION ACT OF 1976, S. REP. No. 1005, 94th Cong., 2d Sess. 59 (1976).

185 *Id.*

186 *Economic Hearings, supra* note 193, at 76 (statement of F. M. Scherer).

such an interpretation. A paper prepared by the Bureau of Competition of the Federal Trade Commission noted the following oil and gas company uranium holdings: from 1960 to 1974, the four-firm concentration ratio of uranium production rose from 51.4 pecent to 61.3 percent.[187] The four-firm concentration ratio measures the percentage share of output accounted for by the four largest firms in the industry. In January, 1975, twelve oil and gas companies held 52 percent of the nation's uranium reserves, not including the substantial reserves obtained by Atlantic Richfield as a result of its subsequent acquisition of Anaconda.[188] Of the current top four uranium holders, three are oil companies: Gulf, Exxon, and Kerr-McGee.[189]

Oil and gas company holdings in the coal industry are also extensive. In 1974, the eight largest oil companies controlled 25 percent of the nation's uncommitted coal reserves,[190] and petroleum companies accounted for 19.1 percent of total coal production.[191] If one excludes unleased federal coal reserves from the reserve base because of their peculiar constraints on leasing, oil companies controlled 43 percent of high quality surface-mineable western coal.[192] Presently, 16 of the 20 largest oil companies have coal interests, and oil companies are 2 of the 4 largest reserve holders.[193] In light of acquisitions since 1974, the current aggregate market share of the oil companies in coal reserves and production is probably much higher than the 1974 figures indicate.[194]

Conclusions drawn from these and other findings have been varied. An FTC report has concluded that the domestic uranium industry is workably competitive and that the involvement of the petroleum companies has had a positive effect.[195] However, a report to the FTC criticized the Commission's own report for ignoring the importance of regional markets and insisted that

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187 "Competitive Implications," *supra* note 172, at 76-77.
188 *Id.*
189 *Id.*
190 *Act Hearings, supra* note 30, at 239 (statement of Alfred F. Dougherty).
191 *1978 Joint Hearings, supra* note 172, at 79.
192 *Id.* at 16.
193 *Act Hearings, supra* note 30, at 239 (statement of Alfred Dougherty).
194 *Id.*
195 J. Mulholland, J. Haring & S. Martin, AN ANALYSIS OF COMPETITIVE STRUCTURE IN THE URANIUM SUPPLY INDUSTRY: STAFF REPORT TO THE FEDERAL TRADE COMMISSION 4-5 (1979).

serious anti-competitive problems exist in the industry.[196] A study conducted by the Tennessee Valley Authority (TVA) stressed the higher concentrations in regional markets, and asserted that the rising prices of uranium and coal are directly attributable to the entry of the petroleum companies into those industries.[197] The American Petroleum Institute (API) criticized the TVA study in turn for exclusive reliance on structural evidence (*i.e.*, concentration ratios) to measure competition because the causal link that is said to run from structure to performance has not been demonstrated; rather it has been assumed.[198] API also discounts the significance of the higher concentration figures for regional markets because recent developments, especially in the area of transporting coal, make the relevant market the national one.[199] The API report looks instead to the significant number of entrants into the domestic uranium industry as an indication that petroleum companies do not dominate that industry.[200] The Council on Wage and Price Stability also contested TVA's conclusion that the entry of petroleum companies into the coal industry has caused a rise in coal prices. The Council found that "there is no plausible evidence of significant market power nor of price manipulation by either the largest coal companies or by the oil and other non-coal parent companies as of 1972."[201]

Statistics are inconclusive as to whether withholding is presently occurring in the coal industry. However, the proponents of S. 1246 have interpreted the failure of the oil industry to achieve technological breakthroughs in alternative energy sources as an indication that withholding will occur in the future. According to a spokesman for the TVA, there is "no evidence that the oil industry has made any technical contribution to the

196 J. W. Wilson & Associates, Inc., Report to Director, Bureau of Competition, Federal Trade Commission, on Report to the Federal Trade Commission on the Structure of the Nation's Coal Industry and Report to the Federal Trade Commission on Competition in the Nuclear Fuel Industry (1978), *reprinted in 1978 Joint Hearings, supra* note 172, at 111.

197 Tennessee Valley Authority, The Structure of the Energy Markets: A Report of TVA'S Antitrust Investigation of the Coal and Uranium Industries: 1979 Update (1979).

198 American Petroleum Institute, The TVA on Competition in the Coal and Uranium Industries 2 (1979).

199 *Id.* at 6-12.

200 *Id.* at 16-18.

201 U.S. Council on Wage and Price Stability, A Study of Coal Prices 42 (1976).

mining of coal, production of coal, or pollution control aspects of coal."[202] A National Science Foundation study showed that the total amount spent on research and development of synthetic crude oil in 1978, including federal subsidies, was only $200 million.[203] This indicates that, although the major oil companies are among the very few firms with the capital and technology necessary to develop alternate energy resources, they have not committed themselves to the task. Alfred Dougherty of the FTC has stated that, "this less than aggressive development of alternative energy resources may reflect competitive failures in the oil industry that are spreading to the entire energy sector . . . ."[204]

However, the Justice Department has concluded that there is no evidence that oil companies have an incentive to withhold the production or development of alternative fuels:

> This finding is reinforced by the existence of divergent incentives and expectations among the holders for coal reserves. Firm asymmetry always presents problems for coordinated anticompetitive behavior. But here there is a special problem. The most preferred price and quantity of coal for any given firm would depend on the relative proportion of its income from coal and the alternative fuel. Firms mainly in the nuclear business, for example, would want coal output restricted more than firms that are more directly dependent on coal for profit. Resolution of this conflict might require that output be restricted to that level favored by the firm desiring the least restriction on output. Otherwise, firms which favored less restriction on output would have a tremendous incentive to cheat.[205]

In summary, substantial interfuel substitution is not presently a reality. Whether the oil industry is competitive, "[t]he general policy conclusion with respect to interfuel competition is that oil entry into coal and uranium has not resulted in monopolization of the nation's energy supplies, and antitrust action to halt further entry and/or divestiture, is not economically justified on the basis of the current situation."[206]

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202 *S. 600 Hearings, supra* note 57, at 405 (statement of S. David Freeman).
203 Wash. Post, June 11, 1979, at 4, col. 2.
204 *Act Hearings, supra* note 30, at 238 (statement of Alfred Dougherty).
205 U.S. Dep't of Justice, Competition in the Coal Industry 106 (1978).
206 T. Duchesneau, Competition in the U.S. Energy Industry 187 (1975).

VIII. International Aspects of S. 1246

The ramifications of S. 1246 could detrimentally affect the United States' energy and foreign policies because of the international reach of the major American oil companies. Having long expanded their operations overseas, these companies are genuinely multinational in character. Regulations extending to foreign operations may block the participation of American companies in overseas energy development and may encroach upon the jurisdiction of foreign nations.

Extending the prohibitions of S. 1246 overseas could hinder energy development by limiting the options open to the major oil companies in several ways. These companies would be prohibited from entering into non-energy-related joint ventures which might be necessary to obtain access to certain foreign supplies. Saudi Arabia, for example, has requested that the oil companies join in capital-intensive joint ventures, as part of a plan to build an industrial base not dependent on oil, in exchange for an entitlement to crude oil.[207] A Committee amendment would have permitted participation in the formation of energy-related ventures, but this provision would not allow joining in ventures to maintain access to existing supplies, nor would it allow entering into projects, such as synfuel development, which require additional financing beyond the initial stage.[208] Fewer ventures might be undertaken because the existing partners would be locked in and the major oil companies frozen out, even when additional financial and technical resources were essential to continuing the venture.[209]

The damage to the United States' foreign policy would come as a result of the offense foreign countries might take to enactment of the bill's extraterritorial provisions. As amended by the Committee, S. 1246 sought to recognize the legitimate interests of these countries in exercising jurisdiction over companies incorporated within their boundaries, while seeking to avoid the incentive to invest abroad which would follow from

207 *See* Diplomatic Note 191 from the British Embassy to the Department of State, Oct. 1, 1979; Aide-Memoire from the Royal Norwegian Embassy to the Department of State, Oct. 12, 1979; Diplomatic Note from the Canadian Embassy to the Department of State, Nov. 2, 1979.

208 Minority Rep., *supra* note 11, at 178-80.

209 *Id.* at 179.

limiting the bill's prohibitions to domestic operations.[210] In order to resolve this conflict, the Committee took two steps. First, it exempted from the bill's prohibitions foreign affiliates not subject to control by American producers. This exemption did not extend to the foreign affiliates of American corporations, however. Second, recognizing the jurisdictional disputes which even this restricted version would produce, the Committee amended S. 1246 so that its "applicability to foreign acquisitions shall be interpreted in accordance with the principles of international law and comity."[211]

While international law does permit a state to assert jurisdiction over foreign conduct having direct and substantial effects within its territory,[212] foreign governments are already frustrated by the zeal of the United States in the enforcement of its antitrust laws through an application of this "effects" doctrine broader than that accepted by these governments.[213] George Ball has insisted that S. 1246, even as amended, "would infuriate foreign governments," which "simply would not put up with it" because these governments stress the local character of these enterprises, often large in size and subject to a large degree of local control.[214]

The Committee, on the other hand, believed that balancing the competing interests of the United States and foreign governments by resort to the principles of comity can resolve jurisdictional conflicts with a minimum of friction. Proceeding in this ad hoc fashion would permit foreign countries to argue in each case that local subsidiaries of American parents have a local, not an American nationality, and would permit the United States to assert its vital interest in the maximization of energy investment. Such an approach would call upon each of the contesting nations to moderate the exercise of its jurisdiction by weighing in good faith several factors, including the vital national interests of each, the hardship imposed upon the regulated entity by inconsistent requirements, the extent to which the regulated conduct takes place in the territory of another

210 *Committee Hearings, supra* note 54, at 682 (statement of George Ball).
211 S. REP., *supra* note 5, at 72.
212 *See* RESTATEMENT (SECOND) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 18 (1965).
213 *Committee Hearings, supra* note 54, at 686-87 (statement of George Ball).
214 *Id.* at 683.

state, the nationality of the regulated entity, and the extent to which enforcement of the rule can reasonably be expected to achieve compliance with that rule.[215]

IX. CONCLUSION

The issues raised during the congressional debate over S. 1246 do not lend themselves to easy answers. Despite much conflicting empirical evidence, Congress does not have the luxury of waiting for a clear solution to emerge. However, legislative action in the face of considerable uncertainty also poses serious risks. The challenge facing any legislative body is to devise policies which anticipate problems yet avoid the pitfalls of precipitous action.

Both Democrats and Republicans in Congress share the wish to alleviate America's dependence on imported petroleum and to encourage the major oil companies to increase domestic production. Although Senator Dole, the new Chairman of the Senate Finance Committee, opposed S. 1246, during hearings on the windfall profits tax he expressed his concern over the growing propensity of the petroleum companies to invest their profits in areas other than oil exploration and development. Several conservative Republicans have joined liberal Democrats in arguing that the oil companies should be held accountable for their pledge that increased revenues from decontrol will lead to greater domestic production. While conservatives would clearly prefer an incentive-based approach to accomplish this result, such as a plowback provision in the windfall profits tax, this preference is not inconsistent with limited restrictions on conglomerate acquisitions.[216]

The evidence regarding the economic efficiency of conglomerate mergers is decidedly mixed. In light of this ambiguity, S. 1246's restrictions on the conglomerate merger activity of the

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215 *See* RESTATEMENT (SECOND), *supra* note 212, at § 40.

216 For a discussion of the pros and cons of a plowback provision, *see S. 600 Hearings*, note 57 *supra*. Although a discussion of the plowback concept is beyond the scope of this Article, it should be noted that practical difficulties of drafting a workable plowback mechanism were seen as so great that the concept did not even have united industry support. Nevertheless, the concept of a plowback is an attractive one and for this reason further examination of this issue is merited.

major oil companies rest on an uncertain economic basis. However, it is not at all apparent from the evidence that these restrictions, limited as they are in both time and scope, will have a seriously detrimental impact on the economy as a whole.

Although in relative terms the oil companies have not diverted a large proportion of their funds to such mergers, in absolute terms the amounts are substantial. Indeed, they exceed the total resources devoted by the oil companies to the research and development of alternative energy sources.[217] Given the fact that conglomerate acquisitions contribute little to the resolution of the energy problem and are of dubious benefit to the economy as a whole, it would not be imprudent to restrict them. Not only do the potential energy benefits from such restrictions outweigh the attendant risks, but the political opposition is not nearly as intense as is the case with horizontal acquisitions.

Additionally, S. 1246's affirmative defenses should ameliorate any adverse impacts caused by these restrictions. Although the opponents of S. 1246 argued vociferously that these defenses would prove to be illusory, litigation would not be markedly different from existing section 7 cases. Merger proponents, regardless of the burden of proof, seek to present their own case to prove the pro-competitive aspects of the merger. While shifting the burden of proof may have some marginal effect, it should not be exaggerated.

To obviate the need for protracted litigation, the pre-merger notification requirements of the Antitrust Improvements Act of 1976[218] should be incorporated within S. 1246. This would permit oil companies contemplating a merger to receive advance notification from the FTC or Justice Department as to the applicability of the bill's alternative defenses to their situation.

The risks accompanying restrictions on lateral acquisitions are considerably greater than those placed on conglomerate mergers. While oil companies with ownership interests in alternative fuels may not have as great an incentive to develop these alternatives as would independent companies, the evidence indicates that "integrated firm withholding" has not occurred. Moreover, existing antitrust laws seem relatively adequate to deal with this potential problem. Government leasing

217 S. Rep., *supra* note 5, at 39.
218 15 U.S.C. § 18A (1976).

policies can also play a positive role in promoting competition. Conversely, impeding the transferability of capital and technology from the oil companies to alternative energy resources seems risky in light of the need for a considerable infusion of capital and advanced technology into these industries. At this time, the potential costs of S. 1246's restrictions on lateral acquisitions appear to outweigh the benefits. For these reasons as well as the rather intense political opposition to such restrictions, a revised version of S. 1246 should not limit energy-related acquisitions. However, the legislation should establish an effective monitoring and reporting system to guard against acts inhibiting the development of alternative energy resources.

In addition to concerns over the possible adverse economic or energy-related effects of restricting conglomerate and horizontal mergers, the international ramifications of S. 1246 helped narrow the majority's margin of victory. Unless restrictions were placed on the merger activities of domestically owned foreign subsidiaries, S. 1246 would only divert oil company investment overseas. Such a perverse result would not only defeat the purpose of the legislation but would be highly detrimental to the domestic economy. In a world where business is increasingly transnational, it is difficult to impose purely domestic restrictions on the activities of multinational corporations. Resolution of the conflict between the United States' interest in regulating the investment activities of its domestic oil companies and the desire of foreign governments to exercise primary jurisdiction over businesses incorporated within their borders presents a delicate problem for proponents of any anti-merger legislation. Global interdependence frequently requires governments to adjust their domestic policies in light of the legitimate interests of other nations. By inserting the "international law and comity" provision into the legislation, the sponsors of S. 1246 sought to strike a balance between the interests of the United States and those of foreign governments concerned with preserving their jurisdictional sovereignty over corporations located within their boundaries.

Should the restrictions on horizontal mergers be eliminated, various practical objections of foreign governments to S. 1246's extraterritorial reach would be overcome. No longer would domestic oil companies be barred from entering existing energy-related joint ventures. As to non-energy joint ventures, further

legislative modification may be required. Many OPEC countries — Saudi Arabia, for example — require oil companies to participate in their industrialization efforts as a prerequisite to continued access to oil. An explicit affirmative defense which recognizes that non-energy joint ventures or other forms of acquisitions may be necessary to assure the United States access to foreign supplies would eliminate a serious objection to the bill.

To summarize, a revised bill would restrict only conglomerate acquisitions, retain and strengthen the affirmative defenses, and exempt overseas non-energy-related joint ventures or acquisitions necessary to maintain access to foreign oil supplies. Each side would gain from such a compromise: restrictions on non-energy-related acquisitions by the major oil companies would satisfy both the proponents of S. 1246 and conservative legislators such as Senator Dole who are concerned that the oil companies might continue to invest their profits in non-energy-related ventures.[219] Decontrol would complement S. 1246's coercive approach by providing the higher rates of return necessary to encourage voluntary investment in energy-related projects. Similarly, exemption of energy-related acquisitions from the purview of the legislation would satisfy opponents of S. 1246. The bill's proponents could expect that existing antitrust law would deal effectively with the adverse competitive effects of horizontal mergers and that the federal government, through its leasing policies and grant system, can promote competition in the energy industry. Finally, expansion of the joint-venture exemption would reduce the adverse international consequences of S. 1246.

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219 Consistent with his advocacy of a plowback provision to the windfall profits tax, Senator Dole introduced a similar plowback amendment to S. 1246. This amendment would permit mergers or acquisitions if, in the preceding year, the merger proponent had made energy-related investments equal to or greater than its net income. Although this proposal seems fair on the surface, its practical effect would be to permit virtually unlimited merger activity. As explained in section III *supra*, it is cash flow and not net income that determines the level of oil company investment. Indeed, during the period 1970 to 1978, the companies invested $1.95 for every dollar of net income in energy development.

Despite the inadequacy of net income as a base figure, the Dole concept does have some potential and deserves further study. For example, a formula might be devised utilizing historic investment patterns coupled with minimum increments as the base figure for investment. If a realistic formula can be devised which more nearly approaches cash-flow amounts, the Dole plowback concept could serve as a useful vehicle for expanding the base of support for compromise legislation.

Perhaps it is unduly optimistic to expect such modifications to lead to legislative consensus. Given the current composition of Congress, opponents of the bill may feel no pressure to reach a compromise. Yet, if the prior statements of Republican legislators reflect consistently held beliefs, such a compromise would be in concert with their objectives and concerns. Furthermore, for the supporters of S. 1246, the alternative to compromise is legislative inaction.

Notwithstanding potential conflicts, issues raised by the legislation are significant ones deserving public attention. Because the oil companies based their ultimately successful arguments on behalf of decontrol on the premise that higher prices will lead to increased domestic oil exploration and development, it is proper to inquire into the use the oil companies will make of these increased profits. As Alfred Dougherty of the FTC pointed out during the course of the hearings, "[i]t is essential that Congress and the American people be informed about the use of oil companies' profits, especially decontrol profits, in order to determine whether decontrol has succeeded in creating greater innovation and competition in our energy markets."[220]

Continued legislative scrutiny of non-energy-related mergers or acquisitions will certainly focus attention upon the oil companies' post-decontrol investments. Fear of legislative restrictions may inhibit somewhat the tendency to invest in non-energy-related fields. Thus, regardless of legislative practicalities, anti-merger proposals such as S. 1246 can have the positive effect of spurring the oil companies to even greater efforts to resolve the nation's energy problems. For this reason alone, this legislation should not be abandoned.

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220 *Act Hearings*, *supra* note 30, at 219 (statement of Alfred Dougherty).

ARTICLE

POST-MARKETING SURVEILLANCE OF PRESCRIPTION DRUGS: DO WE NEED TO AMEND THE FDCA?

ROBERT L. FLESHNER*

Current law requires that new prescription drugs undergo lengthy testing before they are marketed, but requires only limited surveillance of their use after they have been approved by the Food and Drug Administration. In this Article, Mr. Fleshner argues that a regulatory scheme oriented more toward post-marketing surveillance and less toward pre-marketing screening would provide several advantages over the present approach and that such a system could be implemented under current law. He also analyzes one recent legislative proposal which would give the FDA explicit authority to implement a post-marketing surveillance system.

Introduction

The issue of whether to implement a system of post-marketing surveillance for prescription drugs continues to cause much concern throughout the health care industries and among those charged with regulating such industries. In 1976, Senator Edward M. Kennedy announced the formation of a non-governmental body, the Joint Commission on Prescription Drug Use, organized to study ways of monitoring drugs currently on the market.[1] He noted the existing imbalance between pre- and post-marketing surveillance:

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1 Culliton, *Adverse Drug Reactions: Monitoring Needed of Drugs on Market*, 195 SCIENCE 159 (1977). The members of the Joint Commission on Prescription Drug Use, and the organizations that nominated them, are:

American Academy of Family Physicians: John F. Derryberry, Chairman, Public Relations Committee, AAFP, and Phillip D. Cleveland, Commission on Health Care Services, AAFP;

American Medical Association: F. Gilbert McMahon, Tulane University School of Medicine, and Daniel Freedman, University of Chicago;

American Society for Pharmacology and Experimental Therapeutics: Daniel L. Azarnoff, University of Kansas Medical Center, and Kenneth L. Melmon, University of California, San Francisco;

American Society for Clinical Pharmacology and Therapeutics: Edward A.

> We simply don't know how different kinds of doctors use different categories of drugs; we don't know the true incidence of adverse reactions nor do we appreciate the very real benefits of appropriate drug use. . . . Millions of dollars, public and private, are spent to assure that a product is safe and effective for a specific purpose *before it is marketed*. . . . [but] once marketed, a physician may use a drug in any dosage, for any purpose — whether or not that purpose has been scientifically evaluated.[2]

On January 23, 1980, the Commission filed its report with the Food and Drug Administration (FDA), urging the implementation of a system of post-marketing surveillance.[3] In a separate action, the Senate recently passed the Drug Regulation Reform Act of 1979,[4] which in part would have empowered the FDA to implement a system of post-marketing surveillance.[5] Although the bill failed to pass the House before the end of the Ninety-sixth Congress, introduction of a similar bill in the new Congress appears likely.[6] Finally, the FDA, pursuant to current regulation, is requiring some applicants to perform surveillance of particular drugs already on the market. According to Judith

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> Carr, Jr., State University of New York, Buffalo, and Marcus M. Reidenberg, Cornell University Medical School;
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> American Hospital Association: William E. Hassan, Jr., Peter Bent Brigham Hospital, and Robert N. Heyssel, Johns Hopkins Hospital;
>
> Pharmaceutical Manufacturers Association: Foster B. Whitlock, Johnson & Johnson, and Monroe Trout, Winthrop Laboratories;
>
> American Pharmaceutical Associations: William R. Bacon, President, APhA Academy of Pharmacy Practice (1972–73) and practicing pharmacist, and Harold H. Wolf, University of Utah College of Pharmacy;
>
> American Society of Hospital Pharmacists: R. David Anderson, Waynesboro University Hospital, Virginia; and,
>
> Public Members: Marcia Greenberger, Attorney, Center for Law and Social Policy, Washington, D.C., Patricia King, Georgetown University Law Center, and Anthony Robbins, Colorado Department of Public Health.

Id.

2 *Id.* (emphasis in original).

3 Joint Commission on Prescription Drug Use, Report (1980). *See also* Wall St. J., Jan. 23, 1980, at 14, col. 2.

4 S. 1075, 96th Cong., 1st Sess., 125 Cong. Rec. S13,471 (daily ed. Sept. 16, 1979) [hereinafter cited as 1979 Bill].

5 *Id.* §§ 128, 129.

6 Sponsors of the 1979 Bill included Senator Richard Schweiker, 125 Cong. Rec. S13,464 (daily ed. Sept. 26, 1979) (remarks of Sen. Kennedy), currently Secretary of Health and Human Services, N.Y. Times, Jan. 22, 1981, § B, at 7, col. 1.

Jones, director of FDA's Division of Drug Experience, "[a]bout '10 or 20' drugs are [currently] undergoing such postapproval testing."[7]

Thus a private commission, Congress, and the FDA have all begun to develop methods of post-marketing surveillance of prescription drugs. But, is such surveillance necessary? And, if so, what will be the most effective means of implementation; are current statutes and regulations issued pursuant thereto sufficient, or is a new drug bill required?

This Article will discuss the need for a system of post-marketing surveillance and analyze the potential for implementation of a such a system under both the current regulatory scheme and those portions of the Drug Regulation Reform Bill of 1979 that would have explicitly authorized a full-scale post-marketing surveillance system.

I. The History and Current State of Drug Regulation

Two concerns, safety and effectiveness, have motivated legislative regulation of the drug industry. The Pure Food and Drugs Act of 1906,[8] representing the first congressional attempt to regulate the drug industry, addressed only the issue of safety. The Act required drug manufacturers to list the type and quantity of potent ingredients in their products and forbade the sale of "misbranded" or "adulterated" mixtures as drugs.[9] That act was superseded in 1938 by the Federal Food, Drug, and Cosmetic Act of 1938 (FDCA).[10] The FDCA retained the labeling provisions of the 1906 Act and also imposed safety-testing requirements upon manufacturers before allowing marketing of new drugs.

Neither the 1906 Act nor the FDCA imposed any requirement that drugs be proven effective in treating the conditions for which they were sold. And the procedure outlined in the FDCA

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7 Wall St. J., note 3 *supra*.

8 Federal Food and Drugs Act of 1906, ch. 3915, 34 Stat. 768 (1906) (repealed 1938).

9 *Id.* §§ 8, 9.

10 Federal Food, Drug, and Cosmetic Act of 1938, ch. 675, 52 Stat. 1040 (1938) (current version at 21 U.S.C. §§ 301–392 (1976)).

for approval of new drug applications (NDAs) contemplated that testing be conducted only prior to marketing.[11]

The 1962 "Kefauver" amendments to the FDCA represented a significant change in congressional policy toward drug regulation.[12] The FDCA as amended now requires that new drugs be proven to be not only safe, but also effective for their intended uses.[13] And while the amendments primarily provide for a pre-marketing clearance procedure, they also authorize the FDA to require a form of post-marketing surveillance. The FDA can mandate that applicants for NDAs maintain records concerning those drugs[14] in order to enable the FDA to make determinations concerning the suspension or withdrawal of drugs from the market contemplated in section 505(e) of the FDCA.[15]

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11 *But see* FDCA, *supra* note 9, § 505(e), which provided that approval of an NDA be withdrawn when new evidence suggested that the drug was unsafe.

12 Drug Amendments of 1962, 76 Stat. 780 (codified in scattered sections of 21 U.S.C. §§ 301–382 (1976)).

13 *Id.* § 102 (amending FDCA § 505(b), 21 U.S.C. § 355(b) (1976)).

14 21 U.S.C. § 355(j)(1) (1976) provides:

> In the case of any drug for which an approval of an application filed pursuant to this section is in effect, the applicant shall establish and maintain such records, and make such reports to the Secretary, of data relating to clinical experience and other data or information, received or otherwise obtained by such applicant with respect to such drug, as the Secretary may by general regulation, or by order with respect to such application, prescribe on the basis of a finding that such records and reports are necessary in order to enable the Secretary to determine, or facilitate a determination, whether there is or may be ground for invoking subsection (e) of this section: *Provided, however,* That regulations and orders issued under this subsection and under subsection (i) of this section shall have due regard for the professional ethics of the medical profession and the interests of patients and shall provide, where the Secretary deems it to be appropriate, for the examination, upon request, by the persons to whom such regulations or orders are applicable, of similar information received or otherwise obtained by the Secretary.

15 21 U.S.C. § 355(e) (1976) provides:

> The Secretary shall, after due notice and opportunity for hearing to the applicant, withdraw approval of an application with respect to any drug under this section if the Secretary finds (1) that clinical or other experience, tests, or other scientific data show that such drug is unsafe for use under the conditions of use upon the basis of which the application was approved; (2) that new evidence of clinical experience, not contained in such application or not available to the Secretary when the application was approved, . . . shows that such drug is not shown to be safe for use under the conditions of use upon the basis of which the applications was approved; (3) on the basis of new information before him with respect to such drug, evaluated together with the evidence available to him when the application was approved, that there is a lack of substantial evidence that the drug will have the effect it purports or is represented to have under the conditions of use prescribed, recommended, or suggested in the labeling thereof.

The amendments also grant the FDA authority to promulgate regulations necessary to facilitate a post-marketing reporting system.[16] These regulations, promulgated first in 1974, add very little detail to the statute.[17] They do not require a post-marketing surveillance system of the scope either contemplated in the 1979 Bill or in effect in many other countries.

II. Is Post-Marketing Surveillance Necessary?

While the term "post-marketing surveillance" encompasses a broad spectrum of potential activities, it necessarily includes a system whereby prescription drugs are studied and reported on subsequent to marketing. Whether such a system be mandatory or non-mandatory, formal or informal, comprehensive or selective, long-term or short-term, the question remains — is such a potentially costly and complicated system necessary?

Because Great Britain has long had a drug regulation policy that couples less stringent pre-marketing clearance procedures with comprehensive post-marketing surveillance,[18] a comparison between its experience and that of the United States is useful in assessing the relative value of such a system. The most important question to consider in making such a comparison is whether the added protection conferred by delaying the introduction of new drugs is greater than the therapeutic losses incurred through such a delay.[19] William Wardell of the Center for the Study of Drug Development, Departments of Pharmacology and Toxicology and of Medicine, University of Rochester Medical Center, has concluded from his comparative study of drug regulation in Great Britain and the United States that Great Britain's policy facilitates the introduction of useful drugs without substantially increasing health risks:

> [I]t is difficult to argue that the United States has escaped an inordinate amount of new-drug toxicity by its conser-

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16 Drug Amendments, *supra* note 12, § 103(a) (amending FDCA § 505(j)(1), 21 U.S.C. 355(j)(1) (1976))

17 *See* 21 C.F.R. §§ 310.300–310.304 (1980).

18 *See* Wardell, *Therapeutic Implications of the Drug Lag*, 15 Clinical Pharmacology and Therapeutics 73 (1974).

19 Lasagna, *Research, Regulation and the Development of New Pharmaceuticals: Past, Present and Future*. 263 Am. J. Med. Sci. 66 (1972).

> vative approach; it has gained little else in return. On the contrary, it is relatively easy to show that Britain has gained by having effective drugs available sooner. Furthermore, the costs of this policy in terms of damage due to adverse drug reactions have been small compared with the existing levels of damage produced by older drugs. . . . [I]t appears that the United States has, on balance, lost more than it has gained from adopting a more conservative approach than did Britain in the the post-thalidomide era.[20]

Wardell points out that pre-marketing screening for safety and effectiveness is inevitably inadequate:

> Toxicity testing in animals can never guarantee a drug's safety in man; neither can the small numbers of closely monitored patients required for premarketing trials of efficacy guarantee its safety in the population at large. Given these facts, the actions of a regulatory agency should hinge to a large degree on the quality of post-marketing surveillance. If post-marketing surveillance is poor or non-existent, then the decision to approve a new drug is a grave and irreversible one; it should be delayed as long as possible (forever?) in the hope that exhaustive preclinical and clinical testing, together with the experience of other countries, will reveal all unsuspected toxicity in the drug before it is approved for marketing. If, on the other hand, post-marketing surveillance is rigorous enough to detect even rare drug toxicity promptly, then drugs could be introduced more rapidly, with confidence that . . . no widespread harm to the community will ensue even if the drug does turn out to induce unsuspected reactions.[21]

Other experts have agreed that a system of post-marketing surveillance presents many advantages. The Joint Commission on Prescription Drug Use found that such a program would provide four major benefits:

> 1. Discovery of adverse effects unknown at the time of marketing. This includes discovery of unknown adverse drug interactions.
>
> 2. Quantification of the risks of known adverse effects. The recognition may be based upon information available at the time of marketing, or it may derive from post-marketing surveillance. Inherent in this quantification is evaluation of the modification of adverse drug effects by var-

20 Wardell, *supra* note 18, at 90.
21 *Id.* at 91.

ious patient characteristics, concomitant drugs and other factors.

3. Quantification of drug efficacy. The efficacy information derived in phase III research requires supplementation after marketing with respect to (a) the types of patient (age, concomitant illness, drugs, etc.), (b) the types of therapeutic practice (dosage and duration), (c) longer-term efficacy, and (d) efficacy in reference to new indications.

4. Discovery of new indications. Experience with a drug may reveal a side effect which may provide a *new* use (indication for the drug). While many highly useful drug effects have been discovered in this serendipitous manner, it is to be noted that, in contrast to the above objectives, the pursuit of such discoveries after marketing is not primarily a regulatory matter.[22]

Of these, probably the most important advantage is that it can provide a monitoring system that will enable physicians, manufacturers, and researchers to dramatically broaden their knowledge base for marketed drugs. Not only will this make drugs safer for their intended use, but also it will help to detect new uses for such drugs

Post-marketing surveillance could also minimize "drug lag";[23] it might permit drugs to be marketed in less time after their initial discovery than is now the case. There has been a divergence of views and a great deal of controversy surrounding the drug-lag issue. Donald Kennedy, the former Commissioner of the FDA contends that drug lag is an international phenomenon having little to do with the regulatory climate in the United States.[24] Instead, Kennedy feels it is the result of an apparent exhaustion of certain basic knowledge on which the drug companies' earlier breakthroughs were based.[25] He believes that, regardless of the regulatory climate, the downward trend in drug development can be reversed only through "basic innovations in molecular biology, fresh insights in our understanding of certain disease mechanisms, or new therapeutic concepts."[26]

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22 JOINT COMMISSION ON PRESCRIPTION DRUG USE, REPORT, app. III A, at 5 (1980).
23 *See generally* Wardell, note 18 *supra*.
24 Kennedy, *A Calm Look at "Drug Lag"*, 239 J.A.M.A. 423 (1978).
25 *Id.* at 425.
26 *Id.*

Others, including Wardell, disagree with Kennedy.[27] Wardell argues that regulatory inhibitions, while not the sole cause, are largely responsible for the fact that fewer new drugs have been introduced in the United States than in numerous other countries in the past two decades.[28]

In attempting to determine whether drug lag results from FDA regulations, it is crucial to note the length of time it takes in the United States between initial discovery and the eventual marketing of a drug. With respect to an average drug, the total time from the initiation of research through actual marketing can be anywhere from 5-1/2 to 17 years.[29] For example, Navane, a psychotherapeutic drug developed by Pfizer Pharmaceuticals for the treatment of severe mental illness, went through premarket testing for 11-1/4 years before being approved by the FDA.[30] Furthermore, the lengthy approval period in the United States has caused a large number of drugs to be introduced at dates significantly later than in numerous other countries.[31] This indicates that FDA regulatory policy does play an important part in delaying the introduction of new drugs in the United States.[32]

There has been less debate surrounding the other advantages of post-marketing surveillance. Although an increased amount of hard data about marketed drugs would be available to scientists and practitioners under such a system, members of the drug industry will likely argue that their current studies are adequate and that mandatory reporting requirements would only

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27 *See, e.g.*, Wardell, note 18 *supra*; C. ANELLO, FDA PRINCIPLES ON CLINICAL INVESTIGATIONS 14 (1970); *but see* 1 R. SLACK & A. NINEHAM, MEDICAL AND VETERINARY CHEMICALS (1968).

28 Wardell, *The Drug Lag Revisited: Comparison by Therapeutic Area of Patterns of Drugs Marketed in the United States and Great Britain from 1972 Through 1976*, in 24 CLINICAL PHARMACOLOGY AND THERAPEUTICS 499, 521 (1978).

29 A. GORDON & S. GILGORE, THE ART AND SCIENCE OF CONTEMPORARY DRUG DEVELOPMENT 207 (1972).

30 *Id.* at 206.

31 *See* COMPTROLLER GENERAL, REPORT TO THE HOUSE SUBCOMM. ON SCIENCE, RESEARCH, AND TECHNOLOGY: FDA DRUG APPROVAL — A LENGTHY PROCESS THAT DELAYS THE AVAILABILITY OF IMPORTANT NEW DRUGS 68 (1980).

32 *The Food and Drug Administration's Process for Approving New Drugs: Hearings Before the Subcomm. on Science, Research and Technology of the House Comm. on Science and Technology*, 96th Cong., 1st Sess. 13 (1979).

AVAILABILITY OF FOURTEEN THERAPEUTICALLY IMPORTANT DRUGS
(earliest date underscored)
Month and year available

	United States	Canada	Norway	Sweden	Switzer-land	United Kingdom
Beclomethasone dipropionate	May 1976	June 1976	Nov. 1973	Mar. 1974	Nov. 1973	Oct. 1972
Sodium valproate	Feb. 1978	(a)	(b)	(a)	May 1972	Aug. 1972
Cimetidine	Aug. 1977	May 1977	July 1978	June 1978	Sept 1977	Nov. 1976
Protireline	Nov. 1976	(a)	(b)	Dec. 1976	Jan. 1977	Jan. 1975
Vidabrine	Nov. 1976	Aug. 1976	(b)	(c)	(c)	July 1977
Somatotropin	July 1976	(a)	(b)	May 1971	Apr. 1972	Feb. 1972
Sodium iodide I-123	Mar. 1976	(d)	(b)	(c)	(c)	(c)
Diazoxide	May 1976	July 1969	Dec. 1975	(a)	Dec. 1973	(c)
Phospho lipids	Oct. 1975	Oct. 1972	(b)	Feb. 1964	Jan. 1963	Jan. 1975
Amino acids	Dec. 1975	May 1977	(b)	Nov. 1972	Feb. 1966	(c)
Danazol	June 1976	Jan. 1976	May 1978	Oct. 1977	Apr. 1977	June 1974
Prazosin	June 1976	Aug. 1976	Sept. 1976	(a)	June 1974	Oct. 1973
Disopyramide phosphate	Aug. 1977	Mar. 1977	Aug. 1978	May 1978	Mar. 1977	July 1972
Propranolol:						
Arrhythmias	Nov. 1967	July 1968	Sept. 1966	Nov. 1965	Oct. 1965	June 1965
Angina	Nov. 1967	June 1969	Sept. 1966	Nov. 1965	Oct. 1965	June 1965
Hypertension	June 1976	July 1974	Aug. 1972	Nov. 1965	Oct. 1965	Apr. 1969

[a]Under review by agency at completion of our visit.
[b]Not submitted to agency at completion of our visit.
[c]Data not available.
[d]NDA submission canceled.

increase costs.[33] The experience of Great Britain suggests, first, that physician reporting can decrease the potential overall costs of post-marketing surveillance reporting,[34] and, second, that a system of post-marketing surveillance can compensate for increased post-marketing costs by cutting pre-marketing costs.[35]

The benefits of a system of post-marketing surveillance promise to be substantial. Once a post-marketing surveillance scheme begins to run smoothly, and duplication and waste are minimized, the system should not add significantly to the costs incurred in marketing a drug and might well decrease them. Because systems requiring post-marketing surveillance have

33 The 1979 Bill, note 4 *supra*, anticipated such an objection and would require the Secretary to consider the burdens imposed upon those required to conduct post-marketing surveillance. *Id.* § 129 (adding FDCA § 506(c)(3)(A)(v)).

34 CONTROLLING THE USE OF THERAPEUTIC DRUGS — AN INTERNATIONAL COMPARISON 118 (W. Wardell ed. 1978).

35 *See generally* Wardell, note 18 *supra*.

been successfully implemented throughout the world,[36] there is every reason to believe that post-marketing surveillance would succeed in the United States.

III. FDA AUTHORITY TO IMPLEMENT A SYSTEM OF POST-MARKETING SURVEILLANCE UNDER PRESENT LAW

The courts would likely uphold FDA regulations implementing comprehensive post-marketing surveillance under the current statute. Section 505(j) of the FDCA[37] would provide the necessary statutory basis for these regulations. Section 505(j) requires the applicant to maintain and establish records and to make reports to the Secretary[38] when he determines that certain information is necessary to facilitate a decision regarding whether approval of a new drug application should be withdrawn or suspended.[39] Section 505(e) directs the Secretary to withdraw approval of an application if he determines that the drug may be unsafe or that there is a lack of substantial evidence that the drug will have the effect it is claimed to have under the conditions of use prescribed, recommended, or suggested in the labeling thereof.[40] Thus, to enable the Secretary to determine whether he should withdraw or revoke approval of a new drug application, the applicant is required to submit reports relating to the safety and, in a limited fashion, the effectiveness of the approved drug.[41]

An important element of a truly comprehensive post-marketing surveillance system is the requirement that new uses of drugs be reported. Two sections of the regulations appear to require that applicants report such new uses. First, the applicant

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36 *See* CONTROLLING THE USE OF THERAPEUTIC DRUGS, note 34 *supra*.

37 21 U.S.C. § 355(j)(1)(1976).

38 Reference is to the Secretary of the Department of Health and Human Services of which the FDA is a part. In analyzing the FDA's power to implement post-marketing surveillance the terms "FDA" and "the Secretary" will be used interchangeably.

39 21 U.S.C. § 355(e) (1976). *See* notes 14 and 15 *supra*, wherein the text of 21 U.S.C. §§ 355(e) and (j)(1) is set forth.

40 21 U.S.C. § 355(e) (1976).

41 The wording of section 505(e)(3) in regard to effectiveness testing is somewhat contorted. It seems clear, however, that "new use" effectiveness data would not be required to be reported in a post-marketing surveillance scheme implemented under sections 505(j)(1) and 505(e), since section 505(e)(3) speaks only to the effect the drug *purports or is represented to have*.

must report any information relating to any "unexpected side effect, injury, toxicity, or sensitivity reaction or any unexpected incidence or severity thereof associated with clinical uses, studies, investigations, or tests, whether or not determined to be attributable to the drug."[42] Because the term "unexpected" is defined as referring to conditions or developments not previously submitted as part of the new drug application,[43] this regulation clearly çomtemplates new-use reporting.

Second, the regulations define "drug experience," "adverse drug experience," and "adverse reaction" as "any adverse experience associated with the use of the drug, whether or not considered drug-related, and includ[ing] *any* side effect, injury, toxicity, or sensitivity reaction or significant failure of expected pharmacological action."[44] The use of the term "any" to modify side effects, injury, toxicity, and sensitivity reaction indicates that an applicant is required to report such conditions even when they are related to a use *not* contemplated in the new drug application. New-use reporting is also implied by the choice of the phrase "use of the drug," which lacks any modifiers of the noun "use," instead of a phrase such as "contemplated use" or "approved use."

Thus far, the FDA has exercised its authority under section 505(j) to issue regulations mandating full disclosure by drug manufacturers of any information they might have concerning the safety and effectiveness of a drug. The regulations require that an applicant report information necessary to a determination of withdrawal or suspension of approval of a new drug application.[45] The wording here follows rather closely that of

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42 21 C.F.R. § 310.300(b)(2)(i) (1980).

43 *Id.*

44 *Id.* § 310.301(b) (emphasis added).

45 *Id.* § 310.300(a) provides:

> On receiving notification that an application for a new drug is approved, the applicant shall establish and maintain records and make reports that are necessary to facilitate a determination whether there may be grounds for invoking section 505(e) of the act to suspend or withdraw approval of the application, including adequately organized and indexed files containing full reports of any of the following kinds of information, pertinent to the safety or effectiveness of the drug or the adequacy of the methods used in, or the facilities and controls used for, the manufacture, processing, and packing of the drug to assure and preserve its identity, strength, quality, and purity, that has not previously been submitted as part of this application for the drug and which is received or otherwise obtained by him from any source.

the statute, with the significant difference being that the regulation applies to information concerning safety and effectiveness, while the statutory language of section 505(e) and (j), taken together, seems to require only the reporting of information regarding safety and "lack of substantial evidence" of effectiveness.

The FDA has, however, reserved the right to require additional studies where it finds that the delay in introducing the drug pending long-term studies is "against the public interest."[46] Where the FDA has made such a finding, it "may approve the new drug application on condition that the necessary long-term studies will be conducted and the results recorded and reported in an organized fashion."[47] Thus far, the FDA has exercised this option only in the case of methadone, a synthetic narcotic used as a heroin substitute,[48] but its potential application is enormous. Ultimately, the FDA could adopt such a procedure as the standard method of new drug approval, which is in fact the method contemplated in the 1979 Bill.[49]

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46 *Id.* § 310.303(a) provides in part:

> A new drug may not be approved for marketing unless it has been shown to be safe and effective for its intended use(s). After approval, the applicant is required to establish and maintain records and make reports related to clinical experience or other data or information necessary to make or facilitate a determination of whether there are or may be grounds under section 505(e) of the act for suspending or withdrawing approval of the application. Some drugs, because of the nature of the condition for which they are intended, must be used for long periods of time — even a lifetime. To acquire necessary data for determining the safety and effectiveness of long-term use of such drugs, extensive animal and clinical tests are required as a condition of approval. Nonetheless, the therapeutic or prophylactic usefulness of such drugs may make it inadvisable in the public interest to delay the availability of the drugs for widespread clinical use pending completion of such long-term studies.

47 *Id.*

48 *Id.* § 310.304(b).

49 In its report accompanying the Drug Regulation Reform Act of 1979, the Senate Committee on Labor and Human Resources did not disagree with the notion that FDA has current post-marketing surveillance authority. It spoke of granting FDA further authority and then stated that, "this new authority does not supersede any authority to require surveillance that FDA may have under current law and does not affect any existing surveillance requirements imposed by FDA." S. REP. No. 96-321, 96th Cong., 1st Sess. 39 (1979).

IV. Post-Marketing Surveillance Under the Drug Regulation Reform Act of 1979

On September 26, 1979, the Senate passed the Drug Regulation Reform Act of 1979.[50] The history of the bill dates back to 1967 when the Monopoly Subcommittee of the Senate Select Committee on Small Business commenced a series of public hearings on various aspects of the pharmaceutical industry.[51] In 1973, the Health Subcommittee of the Senate Labor and Public Welfare Committee, headed by Senator Kennedy, also began to examine the United States system of drug regulation.[52] Between 1973 and 1978, the Health Subcommittee held over 35 days of public hearings.[53] In response to questions raised during several of the hearings, a panel was organized on February 21, 1975, to study current FDA policies and procedures relating to the review of new drugs. The panel determined that one of the four areas in which improvements were necessary was post-marketing surveillance.[54] The subcommittee, after considering and acting upon many of the panel's recommendations, unanimously ordered the bill favorably reported to the Committee on Labor and Human Resources,[55] which, after a number of further revisions, ordered the bill favorably reported to the Senate.[56] The Senate then passed the bill, but the House failed to act on it before the end of the Ninety-sixth Congress.

The 1979 Bill is nevertheless significant. Because it embodied the concerns of legislators with such diverse views as Senators Kennedy, Javits, and Schweiker, all of whom were sponsors,[57] its successor should enjoy great bipartisan support. Senator Schweiker's new position as Secretary of Health and Human Services[58] puts him in an excellent position to push for passage of similar legislation.

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50 1979 Bill, note 4 *supra*.
51 S. Rep. No. 96-321, 96th Cong., 1st Sess. 10 (1979).
52 *Id.*
53 *Id.*
54 *Id.* at 11.
55 *Id.*
56 *Id.*
57 125 Cong. Rec. S13,464 (daily ed. Sept 26, 1979) (remarks of Sen. Kennedy).
58 N.Y. Times, Jan. 22, 1981, § B, at 7, col. 1.

Two sections of the 1979 Bill are particularly pertinent to the potential implementation of a system of post-marketing surveillance. The first, entitled "Distribution and Dispensing Requirements, Post-Marketing Surveillance, Further Scientific Investigations, and Batch Certification," contains the statutory framework necessary to implement a post-marketing surveillance system.[59] The second includes provisions which would authorize the FDA to permit drugs to be marketed, in certain circumstances, at an earlier time than would ordinarily be the case.[60]

The 1979 Bill would amend the FDCA by requiring that the FDA, in considering whether to approve a new drug application, also consider imposing post-marketing surveillance requirements as a condition of NDA approval.[61] If it imposed requirements, the FDA would have to set forth in writing its reasons for such imposition.[62] The amendments would also allow the FDA to renew the imposition of requirements provided that it gave notice to the manufacturers involved, published its intentions in the Federal Register, and allowed adverse parties an opportunity for an informal hearing.[63]

Thus, the 1979 Bill would grant the FDA broad discretion to require post-marketing surveillance "at the time an application is approved . . . if [the FDA] determines that such a requirement is necessary *or* useful in evaluating the continuing safety of the drug."[64] Additionally, post-marketing surveillance could be required "in any other case, if FDA determines that such a requirement has become necessary *and* useful in evaluating the continuing safety of the drug."[65]

The use of the phrase "necessary *or* useful" indicates a desire to grant a greater degree of discretion to FDA when the determination is in regard to a new drug application. The Senate, however, clearly did not intend that the FDA impose the requirement on all applicants for new drug approval. "With re-

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59 1979 Bill, *supra* note 4, at § 129 (amending FDCA § 506, 21 U.S.C. § 356 (1976)).
60 *Id.* § 128 (adding FDCA § 505(m)(1), 21 U.S.C. § 355(m)(1) 1976)).
61 *Id.* § 129.
62 *Id.* § 129(a)(2).
63 *Id.*
64 *Id.* (amending FDCA § 506(c)(1)(A)) (emphasis added).
65 *Id.* (amending FDCA § 506(c)(1)(3)) (emphasis added).

spect to a drug whose application is being considered by FDA, the Committee intends that this authority should *only* be used if FDA determines that post-marketing surveillance is either necessary or useful in evaluating the continuing safety of the drug."[66] Nevertheless, the requirement that FDA determine first that post-marketing surveillance will be useful before imposing such conditions on an applicant is minimal and should impose little restraint upon the agency in the exercise of its discretion.

A different situation is presented with respect to both the imposition of post-marketing surveillance on an already-marketed drug and the renewal of a post-marketing surveillance requirement. In these instances the FDA would have less discretion, being required to find that post-marketing surveillance is both necessary *and* useful.[67] A determination that post-marketing surveillance would be useful would not be enough to permit imposition of surveillance on an already-marketed drug or to allow the renewal of a post-marketing surveillance requirement.[68]

The wording of the amendment creates a problem of interpretation insofar as post-marketing surveillance is concerned. Both pertinent subsections mention post-marketing studies in the context of their potential use in evaluating "the continuing safety of the drug."[69] Nowhere is the term "effectiveness" used. Yet, the FDCA presently requires as a condition of pre-market approval that the drug be demonstrated to be not only safe, but effective as well.[70] The meaning of the language of the amendments, when considered in the context of pre-market approval requirements, leads to the conclusion that the Senate committee must have meant for effectiveness testing to be performed prior to marketing of the drug. Closer inspection of the 1979 Bill, however, reveals that such might not be the case. One amended section defines the term "safe," as it is used in that section, as including findings based on the drug's effectiveness.[71] This

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66 S. REP. No. 96-321, 96th Cong., 1st Sess. 39 (1979) (emphasis in original).
67 *Id.*
68 S. REP. No. 96–321, 96th Cong., 1st Sess. 39 (1979).
69 1979 Bill, *supra* note 4, at § 129.
70 FDCA § 505(a) and (b)(1), 21 U.S.C. § 355(a) and (b)(1) (1976).
71 1979 Bill, *supra* note 4, at § 128 (amending FDCA § 505(k)(1)). The amended section would read:

is not the case, however, with the major amendment dealing with post-marketing surveillance.[72]

Additional sections of the 1979 Bill would require the FDA, as a precondition to the imposition of post-marketing surveillance requirements, to promulgate regulations explaining how such surveillance would further attempts to evaluate the drug's safety[73] and to receive and review the report of the Joint Commission for Prescription Drug Use.[74] That report and the FDA's conclusions regarding it are then to be published in the Federal Register for public notice and comment.[75]

In addition to the above requirements, the 1979 Bill would also require, as a prerequisite to a determination regarding the imposition of post-marketing surveillance, that the Secretary consider a number of other factors.[76] These factors include: the uniqueness of a drug; the dosage form; the extent of experience with related drugs;[77] the frequency and magnitude of identified risks;[78] the various known pharmacological effects of the drug;[79]

> As used in this section, the term "safe" means that the health benefits of the drug outweigh the health risks presented by the drug, taking into account the standards, requirements, and conditions applicable to the drug under this section and chapter. In determining whether a drug is safe, the Secretary shall consider, among other things, the following:
>
> (1) The benefits of the drug and their significance. In considering such benefits, the Secretary shall consider the known effects on the health of patients, and the frequency and magnitude of these effects, *that result from the effectiveness of the drug* when such patients use the drug under the conditions of use set forth in labeling for the drug.

Id. (emphasis added). *See also* 21 C.F.R. § 310.300 (1980), which discusses post-marketing surveillance for both safety and effectiveness.

72 Allan M. Fox, former general counsel to the Senate Health Subcommittee explains that, in fact, the post-marketing surveillance requirements were initially in the same section as the definition of "safety." However, as a part of one of the numerous amendments to the bill, the post-marketing surveillance requirements were moved to section 506. Interview with Allan B. Fox in Washington, D. C. (May 20, 1980).

73 1979 Bill, *supra* note 4, at § 129. The amended section 506(e)(2)(A) would read:

> No drug may be subjected to a requirement under paragraph (1) except pursuant to regulations established by the Secretary regarding the circumstances in which, and methods by which, surveillance of drug use and experience would or would not be useful and necessary in evaluating the continuing safety of drugs.

Id.

74 *Id.* For a description of the Joint Commission on Prescription Drug Use, *see* note 2 *supra*,

75 1979 Bill, *supra* note 4 at § 129.

76 *Id.* (amending FDCA § 506(c)(3)(A)).

77 *Id.* (amending FDCA § 506(c)(3)(A)(i)).

78 *Id.* (amending FDCA § 506(c)(3)(A)(ii)),

79 *Id.* (amending FDCA § 506(c)(3)(A)(iii)).

the scope and extent of surveillance necessary to gain appropriate data and information;[80] the burdens surveillance will impose on those required to conduct it;[81] the alternatives to surveillance;[82] and, the extent to which the drug is expected to be used by children, pregnant women, or the elderly.[83]

The 1979 Bill further directs the Secretary to require each manufacturer of a drug upon which a system of post-marketing surveillance has been imposed to join in the establishment and maintenance of a system for the identification, collection, and reporting of data regarding the drug.[84] Such authority has been included in the hope that joint data gathering and reporting will lessen the burden on industry and enhance the value of the information received by FDA.

The final two provisions relating to post-marketing surveillance would require the Secretary to submit his post-marketing surveillance proposals to an advisory committee for its consideration,[85] and would limit the imposition of post-marketing requirements to five years.[86] These provisions do not significantly limit the FDA's discretion. The advisory committee would have only the power to "consider" the proposed post-marketing surveillance system and offer its opinion. The significance of the five-year limit on the imposition of post-marketing surveillance is tempered by its being subject to renewal.

Limited post-marketing surveillance authority would also be provided in the context of regulating "breakthrough" drugs.[87] Drugs meeting all approval requirements except testing for premarketing effectiveness,[88] and which are meant to deal with severely debilitating or life-threatening medical problems,[89] and potentially provide either the only effective method of care[90] or a significantly safer or more effective method of care,[91] could

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80 *Id.* (amending FDCA § 506(c)(3)(A)(iv)).
81 *Id.* (amending FDCA § 506(c)(3)(A)(v)).
82 *Id.* (amending FDCA § 506(c)(3)(A)(vi)).
83 *Id.* (amending FDCA § 506(c)(3)(A)(vii)).
84 *Id.* (amending FDCA § 506(c)(3)(B)).
85 *Id.* § 130 (amending FDCA § 507).
86 *Id.* § 129 (amending FDCA § 506(c)(5)).
87 S. REP. No. 96-321, 96th Cong., 1st Sess. 37 (1979).
88 1979 Bill, *supra* note 4, § 128 (amending FDCA § 505(m)(1)(A)).
89 *Id.* (amending FDCA § 505(m)(1)(B)(i)).
90 *Id.* (amending FDCA § 505(m)(1)(B)(ii)(I)).
91 *Id.* (amending FDCA § 506(m)(1)(B)(ii)(II)).

be marketed provided certain other requirements are met. First, the manufacturer must demonstrate that marketing the drug would subject patients to fewer risks than they would be subject to if marketing was delayed.[92] Next, it must show "significant evidence"[93] of effectiveness.[94] Finally, since approval would involve the marketing of a drug on the basis of a lower standard of effectiveness, a manufacturer would be required to conduct post-marketing surveillance in the form of adequate and well-controlled effectiveness studies.[95]

The provisions of the 1979 Bill discussed above relating to post-marketing surveillance and breakthrough drugs are a strong step toward a comprehensive program aimed at shortening the front end of drug studies and lengthening the back end. In addition, the amendments would provide a more stable and valuable data base for physicians, clinicians, and manufacturers. While there are still technical difficulties with wording that may lead to problems of interpretation, the thrust of the 1979 Bill is clear. It would grant the FDA broad discretion to impose a system of post-marketing surveillance and would allow the FDA to permit earlier marketing of, at the very least, certain breakthrough drugs, and probably many of other drugs.

Conclusion

Drug regulation in this country is in need of reform. Examination of the post-marketing surveillance systems of other countries[96] suggests that the United States could both implement and also benefit greatly from a similar system. It is probable that a comprehensive scheme of surveillance subsequent to marketing could be fashioned under present regulatory authority.[97] Nevertheless, the FDA, insofar as it has chosen to exercise its authority to impose post-marketing surveillance, has done so on an extremely selective and limited basis,[98] most likely

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92 *Id.* (amending FDCA § 505(m)(1)(C)).

93 "Significant evidence" is defined as referring to valid and meaningful scientific investigations conducted by experts. 1979 Bill, *supra* note 4, at § 128 (adding FDCA § 505(m)(2)).

94 *Id.* (adding FDCA § 505(m)(1)(D)).

95 *Id.* (adding FDCA § 505(m)(4)).

96 *See generally* CONTROLLING THE USE OF THERAPEUTIC DRUGS, note 34 *supra*.

97 *See* text accompanying notes 37 to 49 *supra*.

98 Wall St. J., Jan. 23, 1980, at 14, col. 2.

because of the fear that such exercise could cause significant delay in the implementation of such a system by triggering a flood of litigation. The FDA's dilemma becomes even more acute when the agency is confronted with the possible passage of legislation like the 1979 Bill. At first blush it appears that the agency could simply wait until the 1979 Bill is re-introduced and becomes law. At that time, its authority would be clarified and broadened to permit the imposition of post-marketing surveillance. The problem with this approach, however, is that actual passage of the 1979 Bill may still be far down the road. Thus, for present FDA purposes, the 1979 Bill may simply be the carrot that the donkey cannot reach.

FDA implementation of post-marketing surveillance and quicker marketing procedures is paralyzed by the delay in enactment of a new drug-regulation bill. Nevertheless, the FDA should closely monitor drug use and in the event of a health emergency calling either for the earlier marketing of a drug or for strict post-marketing surveillance, the FDA should be prepared to rely on its authority under current law in order to protect the public. Meanwhile, drug-regulation reform legislation requires prompt attention from both legislators and administration policy-makers.

ARTICLE

"ENCOURAGING" REPAYMENT UNDER CHAPTER 13 OF THE BANKRUPTCY CODE

LYNN M. LOPUCKI*

The requirement that creditors consent to extension or composition repayment plans was not carried forward in chapter 13 of the Bankruptcy Reform Act of 1978. In this Article, Professor LoPucki examines the discordant judicial attempt to exact payments from chapter 13 debtors in the absence of a creditor-consent requirement. He further evaluates proposed legislation which would measure the adequacy of debtors' payments by a "good faith effort" test. In arguing that the proposed "good faith effort" test should not be enacted, the author maintains that the test would not achieve its goal of decreasing the stigma associated with chapter 13 proceedings but would irrationally compound the inequities inherent in the debtor-relief system. Anticipating the enactment of the "good faith effort" test, however, Professor LoPucki concludes by suggesting legislative and judicial actions which would mitigate the test's inequities.

Introduction

For forty years, chapter XIII of the Bankruptcy Act[1] provided the wage-earner debtor with an alternative to "straight bankruptcy." Under chapter XIII the debtor could propose either an extension or a composition[2] of his debts to be paid out of his future earnings. If the plan was accepted by the requisite

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1 Throughout this Article the Bankruptcy Reform Act of 1978, Pub. L. No. 95-598, will be referred to as the "Bankruptcy Code" and the earlier act will be referred to as the "Bankruptcy Act." Both the Bankruptcy Code and the Bankruptcy Act are divided into "chapters" which apply to particular bankruptcy court proceedings. Throughout this Article, "chapter XIII" refers to provisions of the Bankruptcy Act and "chapter 13" refers to roughly corresponding provisions of the Bankruptcy Code.

2 A "composition" under chapter XIII of the Bankruptcy Act differs from the contractual remedy of composition only in that the bankruptcy court has the authority to impose the composition plan on dissenting creditors. "Extension" under chapter XIII of the Bankruptcy Act or chapter 13 of the Bankruptcy Code should be considered a term of art. Plans under those chapters not only extend the debtor's time in which to pay; they do so without interest, and impose the expenses of the chapter proceeding on the creditors. 11 U.S.C. § 502(b)(2) (Supp. III 1979); *see* REPORT OF THE COMMISSION ON THE BANKRUPTCY LAWS OF THE UNITED STATES, H.R. DOC. No. 93-137, 93d Cong., 1st Sess. 161 (1973) [hereinafter cited as COMMISSION REPORT].

majorities[3] of creditors, the court could make the plan binding upon dissenters, thus theoretically making it possible for the debtor to avoid the stigma of filing bankruptcy.

Probably as a result of procedural complexities and the fact that the debts of most wage earners are small, few creditors participated in the voting procedure.[4] The National Commission on the Bankruptcy Laws of the United States, which reported to Congress in 1973 in anticipation of a proposed general overhaul of the bankruptcy laws, noted this low level of participation and recommended deletion of provisions allowing creditors to vote on the plan. The commission proposed employing "statutory standards" to determine the amount of payment that debtors must offer to pay their creditors. The commission believed this method would provide the "best assurance of the protection of creditors' interests."[5] The recommendations were enacted into law as part of the Bankruptcy Reform Act of 1978.

This fundamental change in the nature of chapter XIII (which became chapter 13 of the new law) has not proceeded smoothly. The "statutory standards" adopted by Congress in 1978 seem to mandate confirmation of any proposed plan which would pay creditors as little as they would get in "straight bankruptcy." Thus there was speculation that chapter 7 of the new law ("straight bankruptcy") would always be an inferior remedy for debtors and therefore was largely obsolete before it even became law.[6] More importantly, if debtors could take full advantage of the new chapter 13 by proposing minimum payment plans, the practical effect of chapter 13 would be drastically different from that of chapter XIII, where full repayment had been the rule, and composition of debts the exception.[7]

The response of the bankruptcy courts was swift and discordant. In what was perhaps the largest outpouring of opinions on a single subject in their history, measured either in number of opinions or number of different results, the bankruptcy courts throughout the United States adopted sometimes widely differ-

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3 The requirement was for a majority in each class of creditors, Bankruptcy Act § 652(1), 11 U.S.C. § 1062(1) (1976).

4 COMMISSION REPORT, *supra* note 2, at 162.

5 *Id.*

6 *See, e.g.*, Lee, *Chapter 13, nee Chapter XIII*, 53 AM. BANKR. L.J. 303, 303 (1979).

7 *See* authorities cited at note 120 *infra*.

ing interpretations of the new "statutory standards" and Balkanized chapter 13 in less than one year. Depending upon the district in which he filed, by the fall of 1980 the same debtor might have obtained chapter 13 relief by offering his unsecured creditors no payments[8] or he might have been denied relief if he offered them anything less than 70 percent of their unsecured claims.[9]

The congressional attempt to remedy the discordance is in the form of a technical amendments bill which will seek to clarify the "statutory standards" required for confirmation of chapter 13 plans. As presently formulated, the proposed clarification requires the chapter 13 debtor to make a "good faith" or "bona fide" effort.

It is the thesis of this Article that a "good faith effort" requirement is highly ambiguous, and will be arbitrary in its effect and fundamentally unfair. Part I of this Article describes the changes in the payments requirements made by Congress in adopting chapter 13. Part II summarizes the case law construing these legislative changes. Part III describes the proposed changes in the payments requirements made by technical amendment bills introduced in 1980. Part IV considers two problems in interpreting the 1980 proposals, and part V projects and considers some practical consequences of such legislation. Part VI compares the practical consequences of the proposed "good faith effort" test with those of "involuntary" chapter 13 proposals; part VII contains conclusions and recommendations.

I. Changes in the Payments Requirements Made by the Bankruptcy Reform Act of 1978

Under chapter XIII of the Bankruptcy Act the debtor was required to offer payment proposals which met two primary requirements: the proposed amount had to be consented to by vote of the creditors,[10] and the proposal had to be "in the best interests of the creditors."[11] The requirement that the creditors

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8 *See, e.g.*, cases cited at note 17 *infra*.

9 *See, e.g.*, In re Raburn, 4 B.R. 624 (B.C.M.D. Ga. 1980); In re Burrell, 2 B.R. 650 (B.C.N.D. Cal. 1980), *rev'd* 6 B.C.D. 900 (D.C.N.D. Cal. 1980).

10 Bankruptcy Act § 652, 11 U.S.C. § 1052 (1976).

11 Bankruptcy Act § 656(a)(2), 11 U.S.C. § 1056(a)(2) (1976). Collier states that "the

consent to the plan was not carried forward into chapter 13 of the Bankruptcy Code because "if the debtor makes an effort to repay his creditors, the creditors should not be able to say that the plan does not propose to pay enough or that it does not do other things that the creditors want."[12] The requirement that the proposal be in the "best interests of the creditors" was conceptually carried forward into the new code as subsection (4) of section 1325(a).[13] The language, "best interests of creditors," was deleted and more specific language was substituted to make it clear that each creditor is to receive under a chapter 13 plan not less than he would in a chapter 7 liquidation. Section 1325(a) became effective on October 1, 1979, and reads as follows:

> (a) The court shall confirm a plan if —
> (1) The plan complies with the provisions of this chapter and with other applicable provisions of this title;
> (2) any fee . . . required . . . , to be paid before confirmation, has been paid;
> (3) the plan has been proposed in good faith and not by any means forbidden by law;
> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claim if the estate of the debtor were liquidated under chapter 7 of this title on such date;
> (5) with respect to each allowed secured claim provided for by the plan —
> (A) the holder of such claim has accepted the plan;
> (B) (i) the plan provides that the holder of such claim retain the lien securing such claim; and (ii) the value, as of the effective date of the plan, of property to be distributed under the plan on account of such claim is not less than the allowed amount of such claim; or
> (C) The debtor surrenders the property securing such claim to such holder; and
> (6) the debtor will be able to make all payments under the plan and to comply with the plan.

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former condition (acceptance by creditors) is not a substitute for the latter (best interests of the creditors)." 10 COLLIER ON BANKRUPTCY ¶ 29.06[3], at 337 (14th ed. 1978) [hereinafter cited as COLLIER (14th ed.)].

12 123 CONG. REC. H11,699 (daily ed. October 27, 1977) (remarks of Rep. Edwards).

13 *See* A. HERZOG & L. KING, BANKRUPTCY CODE, pt. 3 § 1325, at 616 (1979 Collier pamphlet ed.).

The requirement of subsection (3), that the "plan has been proposed in good faith" is virtually identical to the requirement under chapter XIII that "the proposal [be] in good faith."[14] This good faith requirement had been a part of chapter XIII continuously since 1938, yet had never been construed in a single published opinion.[15] However, the good faith requirement of chapter 13, unlike its predecessor, immediately became a focal point of controversy as the courts searched, or in some cases refused to search, for a provision to replace the creditor consent requirement and prevent "Chapter 13 plans from turning into mere offers of composition plans under which payments would equal only the non-exempt assets of the debtor."[16] Explanations as to why the controversy has focused on the good faith requirement are explored in part II.

II. Case Law Interpreting the Bankruptcy Reform Act of 1978

Several bankruptcy courts have taken the position that the requirement of "good faith" in section 1325(a)(3) is not, in and of itself, a basis for the court to require that any payments be made.[17] Generally, these cases reason that Congress, in enacting the new "best interests of creditors" test of section 1325(a)(4), specifically addressed itself to the issue of what minimum payments were to be required. Nowhere, the reasoning proceeds, in the legislative history or the Code, is it suggested that the term "good faith" was intended to add a second minimum payment requirement. Therefore, the courts should not "spin a web of nebulous judicial requirements for confirmation that have not been made by Congress."[18] If the debtor wishes to

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14 *Compare* Bankruptcy Act § 656(a)(4), 11 U.S.C. § 1056(a)(4) (1976) *with* Bankruptcy Code § 1325(a)(3), 11 U.S.C. § 1325(a)(3) (Supp. III 1979).

15 *See* 5 Collier on Bankruptcy ¶ 1325.01[c], at 1325-28 (15th ed.1980) [hereinafter cited as Collier (15th ed.)].

16 Report of the Senate Comm. on the Judiciary, S. Rep. No. 95–989, 95th Cong., 2d Sess. 87 (1978) at 13.

17 *E.g.*, In re Thacker 6 B.R. 861 (B.C.D.W.D. Va. 1980); In re Jenkins, 4 B.R. 278 (B.C.D. Colo. 1980); In re Harland, 3 B.R. 597 (B.C.D. Neb. 1980); In re Thebeau, 3 B.R. 537 (B.C.E.D. Ark. 1980); In re Sadler, 3 B.R. 536 (B.C.E.D. Ark. 1980).

18 In re Terry, 3 B.R. 63, 66 (B.C.N.D. Cal. 1980), *rev'd* 630 F.2d 634 (8th Cir. 1980).

offer his creditors only what they would have been paid under chapter 7, that is his right. If chapter 7 becomes obsolete, that is the will of Congress as expressed in the legislation. This reasoning will be refered to in this Article as "strict construction" of section 1325(a).

In re Jenkins[19] followed the strict construction reasoning to its logical extreme, confirming a plan which paid only one dollar to the holder of a debt. The debt had allegedly been incurred by fraud and might not have been dischargeable under chapter 7. The court recognized that its decision would result in discharge of the debt without a determination of whether the debt was incurred by fraud, but reasoned that "such a result is clearly within the express language of the statute."[20]

Strict construction of section 1325(a)(3) has been a boon to debtors in those districts where it has been adopted. For example, a debtor who has no non-exempt assets for chapter 7 purposes can propose a plan which offers no payments to unsecured creditors. Such a plan satisfies the "best interests of creditors" test of section 1325(a)(4) because the unsecured creditors, in receiving nothing under chapter 13, would be receiving "not less than" they would be paid in chapter 7. Presumably, almost every debtor in a strict construction district would derive greater benefit from filing under chapter 13 than chapter 7. First, chapter 13 provides generally more favorable relief to debtors than chapter 7.[21] Second, chapter 13 can be expected to carry somewhat less stigma than chapter 7 because of its association with chapter XIII of the previous law. Since chapter 13 has been interpreted in other districts to require substantial payments to creditors, there is naturally some confusion of the two interpretations in the credit community. Thus, in the districts adopting the strict construction of section 1325(a), few debtors

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19 4 B.R. 278 (B.C.D. Colo. 1980).

20 *Id.* at 279.

21 This "more generous relief" consists of an automatic stay which protects a codebtor from action by the creditor to collect any portion of the debt which the debtor proposes to pay, 11 U.S.C. § 1301 (Supp. III 1979), the right to pay secured creditors in installments, 11 U.S.C. § 1322(b) (Supp. III 1979), a discharge which applies to more debts, 11 U.S.C. § 1328(a) (Supp. III 1979), the absence of a provision prohibiting use of chapter 13 by debtors who have recently received a discharge, and freedom from the restrictions on the availability of discharge contained in 11 U.S.C. § 727(a) (Supp. III 1979).

eligible for chapter 13 should find reason to file under chapter 7.[22]

A large majority of the reported decisions have rejected the strict construction approach to section 1325. The majority hold that although the "best interests of creditors" test of section 1325(a)(4) imposes a minimum requirement as to the amount which must be paid to unsecured creditors, it is not the only minimum requirement. They find a second minimum payment requirement in the "good faith" provision of section 1325(a)(3). At least three distinct lines of reasoning are utilized by the courts in arriving at this result.

First, some courts note that chapter 13 provides debtors with relief which is generally more favorable than that provided under chapter 7. Many debts not dischargeable under chapter 7 are dischargeable under chapter 13;[23] chapter 13, unlike chapter 7, provides protection for co-debtors;[24] and, a chapter 13 debtor can propose to redeem non-exempt property with installment payments whereas a chapter 7 debtor is required to pay cash.[25] These courts reason that Congress must have intended to exact an offsetting price for the more generous relief, or else it would "be a terrible blunder to ever file a chapter 7 liquidation for individuals who are eligible under chapter 13."[26]

This line of reasoning has some merit. While opponents might respond that Congress may have intended that chapter 7 would be used primarily by partnerships and corporations, the code's legislative history, particularly that portion dealing with the dischargeability of student loans, is to the contrary.[27] Student loans are owed only by individuals. That Congress made them dischargeable in chapter 13, virtually without comment, while

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22 Probably the only advantage of filing under chapter 7 when eligible for chapter 13 is that chapter 7 procedures are simpler in some respects, and perhaps speedier. For example, under chapter 7 the debtor generally makes one less court appearance, since there is no confirmation hearing.

23 *Compare* 11 U.S.C. § 1328(a) (Supp. III 1979) *with* 11 U.S.C. § 523(a) (Supp. III 1979).

24 11 U.S.C. § 1301 (Supp. III 1979).

25 *See* cases cited at note 121 *infra*.

26 In re Cook, 3 B.R. 480, (B.C.S.D. W.Va. 1980); *accord*, In re Henry, 4 B.R. 220, 223 (B.C.M.D. Tenn. 1980); In re Schongalla, 4 B.R. 360, 363 (B.C.D. Md. 1980) (the legislative history of chapter 13 led to the conclusion that the drafters did not intend the liberal provisions of chapter 13 to be used as a disguised chapter 7 liquidation).

27 *See, e.g.*, H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 132-65 (1977).

devoting substantial deliberation to whether they should be dischargeable in chapter 7, represents a clear indication that Congress envisioned frequent filing by individuals of chapter 7 bankruptcy. If Congress had thought that nearly all individuals would file under chapter 13, the student loan debate would have been expected to focus on dischargeability under chapter 13.

The second line of reasoning used to reject the strict construction of section 1325(a) posits that Congress contemplated that substantial payments would be made in chapter 13 cases. Therefore there must be a requirement in chapter 13 that substantial payments be made in each case.[28] These courts are engaging in fallacious reasoning. It is true that the legislative history is replete with optimistic statements as to the amounts which debtors would elect to pay to creditors under chapter 13.[29] Contemplation that substantial payments would generally be made in chapter 13 cases, however, is not the equivalent of a requirement that they be made in each chapter 13 case. The legislative history is silent as to whether substantial payments are required under chapter 13. Most likely, Congress contemplated substantial payments in chapter 13 cases because it believed that debtors wanted to make such payments. Indeed, "[t]he hearings before the Subcommittee indicated strongly that most consumer debtors would rather work out a repayment plan than file straight bankruptcy."[30]

A variation of this second line of reasoning was developed by the District Court for the Northern District of California. The court examined the legislative history which demonstrated that Congress contemplated substantial payments under chapter

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28 *See, e.g.*, In re Henry, 4 B.R. 220, 222-23 (B.C.M.D. Tenn. 1980); In re Hobday, 4 B.R. 417, 418-19 (B.C.N.D. Ohio 1980); In re Iacovoni, 2 B.R. 256, 265 (B.C.D. Utah 1980).

29 *E.g.*, H.R. REP. No. 95-595, 95th Cong., 1st Sess. 118 (1977):

> The purpose of Chapter 13 is to enable an individual, under court supervision and protection, to develop and perform under a plan for the repayment of his debts over an extended period. In some cases, the plan will call for full repayment. In others, it may offer creditors a percentage of their claims in full settlement. . . . The benefit to creditors is self-evident: their losses will be significantly less than if their debtors opt for straight bankruptcy.

S. REP. No. 95-989, 95th Cong., 2d Sess. 13 (1979):

> As in current law, 100% repayment plans will be encouraged by the limitation on availability of a subsequent discharge in § 727(a)(8). This kind of plan has provided great self-satisfaction and pride to those debtors who complete them and at the same time will effect a maximum return to creditors.

30 H.R. REP. No. 95-595, 95th Cong., 1st Sess. 117 (1977).

13 and concluded that Congress did not intend to "change the settled rule that a Chapter XIII plan should result in a substantial payment of debts."[31] The court erred in its conclusion that the rule was "settled" because before that court announced the rule, it did not exist.[32]

The third line of reasoning used by the courts to reject the strict construction of section 1325(a) is also unconvincing. This line of reasoning begins with the general rule that in determining good faith, "the inquiry is directed to whether or not there has been an abuse of the provisions, purpose, of spirit of Chapter XIII in the proposal or plan."[33] Since chapter XIII has a history of substantial payment plans and since Congress' intention was to continue that history, a plan which does not propose substantial payments abuses the "provisions, purpose and spirit" of chapter 13.

This argument rests upon the history of substantial payments under chapter XIII, but it fails to take account of the fact that in creating chapter 13, Congress deleted from chapter XIII the requirement of an affirmative vote of creditors, the very provision which caused substantial payments. The natural inference is that if Congress intended for some requirement to substitute for the creditor-voting provision, Congress would have so stated. Furthermore, the argument's dependence upon congressional intent to continue a substantial payment requirement is subject to the same rejoinder as the second line of reasoning: the legislative history is silent as to whether or not substantial payments are required.

The first of these arguments for rejecting a strict construction of section 1325(a) leads only to the conclusion that there must be a second minimum payments requirement somewhere in chapter 13. Neither it, nor the legislative history, suggests that

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31 In re Burrell, 6 B.C.D. 900, 902 (D.C.N.D. Cal. 1980).

32 The court in *Burrell* cited Perry v. Commerce Loan Co., 383 U.S. 392, 395 (1966) and In re White Birch Park, Inc., 471 F. Supp. 159 (D.C.E.D. Mich. 1979), but neither of these cases recognizes or provides authority for the existence of such a "settled rule." The district court in *Burrell* seemed to be equating a purpose of chapter 13 (to encourage substantial payment) with a minimum requirement (substantial repayment in each case). In that sense, the *Burrell* court's argument proves too much, since *Perry* stated that the intention of chapter 13 was to encourage *full* payment, 383 U.S. at 395. *See generally*, 10 COLLIER (14th ed.), *supra* note 13, at ¶ 29.01–06.

33 10 COLLIER (14th ed.), *supra* note 13, at ¶ 29.06 [6]. This language is frequently quoted in the cases, *e.g.*, In re Tanke, 4 B.R. 339, 340 (B.C.D. Colo. 1980); In re Cloutier, 3 B.R. 584 (B.C.D. Colo. 1980).

the requirement is to be found in the "good faith" provision of section 1325(a)(3). The courts have settled upon the "good faith" provision as containing the second minimum payments requirement for two reasons. First, section 1325 provides that if the requirements of that section are met, the plan "shall" be confirmed, implying that any objection to confirmation must have a basis within the confines of the section. The "good faith" provision is the only provision within that section which is sufficiently ambiguous to contain the second minimum payments requirement.[34] Second, the bankruptcy courts are undoubtedly familiar with the fact that Congress had, under chapter X of the Bankruptcy Act, used the phrase "good faith" not in accordance with its usual subjective meaning which would consider the debtor's state of mind, but rather as a symbol for an objective test that determined whether the "financial, economic, and legal situation of the debtor is one within the contemplation of Chapter X."[35] This chapter X usage had come about because Congress had expressly defined "good faith" in that manner.[36] Although the definition was, by express language, made applicable only in chapter X cases,[37] the example of "good faith" under chapter X prepared the way for the bankruptcy courts to adopt a similar objective test of "good faith" under chapter 13 if some justification existed. That justification has been found in what the bankruptcy courts perceive as a congressional intent to require substantial payments in chapter 13 cases.

Given the difficulty of determining whether or not a second minimum payments test exists in chapter 13, and the difficulty in determing its situs, it is surprising that, by the fall of 1980, a "consensus (was) developing among the Bankruptcy Courts"[38] as to the nature of the second minimum payments requirement. The nature of this consensus and the variations established by some courts can best be illustrated by comparing the cases with the description of the second minimum payments requirement set forth by Judge Mabey in *In re Iacovoni*:[39]

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34 *See, e.g.*, In re Cook, 3 B.R. 480, 484-85 (B.C.S.D. W.Va. 1980).

35 In re Lela & Co., Inc., 551 F.2d 399, 408 (D.C. Cir. 1977); In re Henry, 4 B.R. 220, 222 (B.C.M.D. Tenn. 1980).

36 *See* Bankruptcy Act § 146, 11 U.S.C. § 546 (1976).

37 Bankruptcy Act § 101, 11 U.S.C. § 501 (1976).

38 In re Fredrickson, 5 B.R. 199, 201 (B.C.M.D. Fla. 1980).

39 2 B.R. 256, 268-69 (B.C.D. Utah 1980).

> The following factors may be considered in determining whether a good faith effort to make meaningful payments to holders of unsecured claims has been made:
> 1. The budget of the debtor, *i.e.*, how much the debtor feasibly can pay.
> 2. The future income and payments prospects of the debtor.
> 3. The dollar amount of the debts outstanding, and the proposed percentage of repayment.
> 4. The nature of the debts sought to be discharged; specifically, to what extent the debtor is invoking the advantages of the broader Chapter 13 discharge which may carry with it concomitant obligations of repayment effort.
> [I]f no meaningful repayment can be proposed the debtor is not entitled to Chapter 13 relief.

Note that the *Iacovoni* test has two parts: (1) has the debtor made a sufficient *effort* to pay; and (2) has the debtor proposed a large enough *payment* to unsecured creditors? If the debtor fails to meet either test, chapter 13 relief should be denied.

A. *Pure Effort Tests.*

Although *Iacovoni's* two-part test reflects the majority approach, a few courts seem to have adopted a test based solely upon whether the debtor's effort is sufficient, without any independent requirement as to the size of his proposed payments (hereinafter referred to as a "pure efforts test"). In *In re Curtis*,[40] which was decided prior to *Iacovoni*, the court focused on "whether the payments, periodic and total, represent the best effort which the debtor can apply against the scheduled indebtedness,"[41] and did not discuss the size of the payment in relation to the unsecured creditors' claims except to note that it was 10 percent of those claims. The court went on to make the following comment, which suggests that it would have rejected any "payments" test which might have been proposed:

> As a final consideration, it must be noted that the proposed plan is in the best interest of creditors within the meaning of § 1325(a)(4) of the Bankruptcy Code insofar as it clearly offers them as much or more than they would receive under

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40 2 B.R. 43 (B.C.W.D. Mo. 1979).
41 *Id.* at 44.

> straight liquidation. It is doubtful whether the bankruptcy court can redefine the minimum amounts required to be paid, already defined by the clear letter of that subsection, by importing an immutable higher minimum into the "good faith" provisions of § 1325(a)(3) of the Code.[42]

In *In re Bellgraph*,[43] although the court cited *Iacovoni* with approval, it relied upon *Curtis* to confirm a plan which proposed no payment to unsecured creditors since the debtor was making a great effort to save her home.

B. *Pure Payments Tests.*

A test which examines only the size of the payment in relation to the amount of the unsecured indebtedness is possible. Although no court has indicated that it would apply such a test generally, the court in *In re Armstrong*[44] adopted a pure payments test applicable to a limited class of cases. The court held that where the debtor proposed 70-percent repayment, it was no bar to confirmation that he could easily have paid 100 percent.[45] Thus *Armstrong* said, in effect, that if the payments are high enough, the test is a one-part "payment" test and the level of effort required of the debtor to make the payments becomes irrelevant.

C. *"Payments and Efforts" Tests.*

With the aforementioned variations, the two-dimensional test enunciated in *Iacovani* seems fairly well established. Although application has differed, the mode of analysis has been fairly uniform.[46] In describing the payments part of their tests nearly all courts use the *Iacovoni* language of "meaningful" or sub-

42 *Id.* at 45.

43 4 B.R. 121 (B.C.N.D.N.Y. 1980).

44 3 B.R. 615 (B.C.D. Or. 1980).

45 The debtor in Armstrong proposed to pay 70 percent of his unsecured debts over a period of 25 months, offering no excuse for not continuing payments for 36 months as permitted by Bankruptcy Code § 1322(c), 11 U.S.C. § 1322(c) (Supp. III 1979).

46 In re Patterson, 4 B.R. 239 (B.C.C. D. Cal. 1980); In re Cook, 3 B.R. 480 (B.C.S.D. W. Va. 1980); and In re Marlow, 3 B.R. 305 (B.C.N.D. Ill. 1980) all recognized the two-dimensional aspect of the "good faith" requirement.

stantial" payments.[47] Proposals of 50 percent[48] and 27 percent[49] of unsecured claims have been considered substantial by courts, while payment proposals of 10 percent or less have been considered insufficient.[50] However, this pattern has been broken by courts in a few cases: *In re Rayburn*,[51] which defines "substantial" as at least 70 percent of unsecured claims; *In re Keckler*,[52] which confirmed a 5-percent plan in an opinion which suggests that any payments, regardless of how small, to unsecured claimants are sufficient; and *In re Moss*,[53] which confirms a 1-percent plan.[54]

Courts have given diverse characterizations to the level of effort required to meet the payments requirement. The "best efforts" language which originated with *Curtis* has been adopted in *In re Marlow*[55] but specifically rejected in *In re Stollenwerck*.[56] *Iacovoni's* "good faith efforts" language has been adopted in *In re Tanke*[57] and *In re Patterson*,[58], while "reasonable efforts" language has also found some support.[59]

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47 *E.g.*, In re Satterwhite, 7 B.R. 39 (B.C.S.D. Tex 1980) (meaningful payment); In re Frederickson, 5 B.R. 199 (B.C.M.D. Fla. 1980) (a consensus developing among the bankruptcy courts that a confirmed chapter 13 plan should provide meaningful payments to the unsecured creditors); In re Barnes, 5 B.R. 376 (B.C.D.C. 1980) (meaningful payments); In re Hall, 4 B.R. 341 (B.C.E.D. Va. 1980) (meaningful or substantial); In re Patterson, 4 B.R. 220 (B.C.M.D. Tenn. 1980) (reasonable and substantial portion of their debts). For slight variations *see* In re Anderson, 3 B.R. 160 (B.C.S.D. Cal. 1980) (reasonable amounts) *and* In re Cook, 3 B.R. 480 (B.C.S.D. W.Va. 1980).

48 In re Powell, 2 B.R. 314 (B.C.E.D. Va. 1980).

49 In re Ryals, 3 B.R. 522 (B.C.E.D. Tenn. 1980).

50 *E.g.*, In re Bloom, 3 B.R. 467 (B.C.C.D. Cal. 1980); In re Fredrickson, 5 B.R. 199 (B.C.M.D. Fla. 1980); In re Blackwell, 5 B.R. 748 (B.C.W.D. Mich. 1980); In re Howard, 3 B.R. 75 (B.C.S.D. Cal. 1980).

51 4 B.R. 624 (B.C.M.D. Ga. 1980).

52 3 B.R. 155 (B.C.N.D. Ohio 1980).

53 5 B.R. 123 (B.C.M.D. Tenn. 1980).

54 The court in *Moss* did not use the term "substantial" or "meaningful" to describe the 1-percent payment. However, the court went to great lengths in that opinion to demonstrate that it was not retreating from its position in In re Henry, 4 B.R. 220 (B.C.M.D. Tenn. 1980), where the court cited *Iacovani* approvingly.

55 3 B.R. 305 (B.C.M.D. Tenn. 1980).

56 5 B.R. 616 (B.C.M.D. Ala. 1980). Other courts rejecting the "best efforts" language include In re Armstrong, 3 B.R. 615 (B.C.D. Or. 1980) (since "best effort" language appears with "good faith" in 11 U.S.C. § 727(a)(9)(B), the two must have different meanings) and In re Powell, 2 B.R. 314 (B.C.E.D. Va. 1980) (single technical amendment bill would add a "best efforts" test, such a test is not included in "good faith").

57 4 B.R. 339 (B.C.D. Colo. 1980).

58 4 B.R. 239 (B.C.C.D. Cal. 1980).

59 In re Schongalla, 4 B.R. 360 (B.C.D. Md. 1980) (the reasonable effort test); In re Cook, 3 B.R. 480 (B.S.C.D. W.Va. 1980) (the debtor's intention must be to make

Further characterizations of the level of effort required are that the debtor should "pay according to his ability and circumstances, thereby providing fairly and responsibly for his creditors within the spirit of chapter 13,"[60] and that creditors are not "entitled to every nickel of excess income over expenditures."[61]

The cases demonstrate little about the practical effect of these various "efforts" formulas. Only *Curtis* attempts to quantify its efforts test by stating that, "in the absence of exceptional circumstances the debtor demonstrates his good faith by proposing to pay at least 10% of his take-home pay over the three year period. . . ."[62] The cases, however, do support two generalizations. First, based upon the few cases that have stated both the income of the debtor and the acceptable payment to unsecured creditors, the *Curtis* rule-of-thumb that the debtor should pay 10 percent of his take-home pay to unsecured creditors seems to have held up well.[63] Second, with the sole exception of *In re Armstrong* (where the debtor proposed payment of 70 percent of all unsecured claims), none of the courts which have applied an efforts test have confirmed a payment as sufficient unless it extended for the statutory maximum of 36 months, or the debtor presented an adequate excuse to justify a shorter payment period. Thus by the application of an "efforts" test, the maximum period over which the payments can be made has become the minimum as well.[64]

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a reasonable effort at debt reduction); In re Bloom, 3 B.R. 467 (B.C.C.D. Cal. 1980); In re Anderson, 3 B.R. 160 (B.C.S.D. Cal. 1980).

60 In re Anderson, 3 B.R. 160, 163 (B.C.S.D. Cal. 1980).

61 In re Powell, 2 B.R. 314, 315 (B.C.E.D. Va. 1980).

62 2 B.R. 45, 46 (B.C.W.D. Mo. 1979).

63 *See* In re Manning, 5 B.R. 387 (B.C.W.D.N.Y. 1980) (The debtors had take home pay of $2600 per month, and proposed to pay nothing to unsecured creditors. The court refused confirmation and suggested a means of freeing up to $310 for payments to unsecured creditors); In re Hall, 4 B.R. 341 (B.C.E.D. Va. 1980) (payment of $75 per month "significant in light of income" of $676 in take-home pay); In re White, 4 B.R. 349 (B.C.E.D. Va. 1980) (payment of $350 from gross income of $3610 apparently acceptable to the court).

64 *See, e.g.*, In re Schongalla, 4 B.R. 360 (B.C.D. Md. 1980) (12 months of payments held insufficient); In re White, 4 B.R. 349 (B.C.E.D. Va. 1980) (27 months of payments held not sufficient); In re Hall, 4 B.R. 341 (B.C.E.D. Va. 1980); *but see* In re Curtis, 2 B.R. 43 (B.C.W.D. Mo. 1979) (18 months of payments acceptable based upon adequate excuse); H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 125 (1977) (House Committee on the Judiciary indicating the three-year limitation of 11 U.S.C. § 322(c) (Supp. III 1979) was to be the maximum, not the norm); In re Markman, 5 B.R. 196 (B.C.E.D.N.Y. 1980) (court held that a plan could provide for payments over less than three years,

To summarize, the bankruptcy courts are divided into three main camps on the issue of "good faith." A majority of courts believe that a plan should not be confirmed unless it provides for payments which are substantial in comparison to the amount of unsecured claims. A smaller number of courts believe that plans providing a nominal payment to unsecured creditors, or even no payment at all, must be confirmed, regardless of the debtor's ability to pay (strict construction position). Finally, a few courts have adopted a test based solely upon the debtor's ability to pay; if the debtor makes a sufficient effort to pay, the plan must be confirmed even if it provides little or no payment on unsecured claims ("pure efforts" position). The technical amendments bill before Congress in 1980 would have rejected the majority and strict construction positions in favor of the "pure efforts" position.

III. The Proposed "Good Faith Effort" Requirement

Even before the Bankruptcy Code of 1978 went into effect in October of 1979, Congress had before it a technical amendments bill which proposed, *inter alia,* to add an efforts test as a prerequisite to confirmation of a plan under chapter 13. As initially adopted by the Senate, the bill would have amended section 1325(a)(3) to read:

> (a)The Court shall confirm a plan if —
>
> . . .
>
> (3) the plan *is the debtor's best effort and* has been proposed in good faith and not by any means forbidden by law [emphasis added].[65]

The House version read:

> (a)The Court shall confirm a plan if —
>
> . . .
>
> (3) the plan has been proposed in good faith and not by any means forbidden by law, *and represents the debtor's good faith effort* [emphasis added].[66]

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commenting that had Congress set a mandatory time period during which the debtor had to work for his creditors, it would have run afoul of the spirit, if not the letter, of the Thirteenth Amendment to the U.S. Constitution).

65 S. Rep. No. 96-305, 95th Cong., 1st Sess. 97 (1979).

66 H.R. Rep. No. 96-1195, 96th Cong. 2d Sess. 138 (1980).

The Senate readopted the bill in December, 1980, with the "good faith effort" test translated into Latin and transferred to subsection (4) of 1325:

> (a)The Court shall confirm a plan if —
>
> . . .
>
> (3) the plan has been proposed in good faith and not by any means forbidden by law,
>
> (4) the value, as of the effective date of the plan, of property to be distributed under the plan on account of each allowed unsecured claim is not less than the amount that would be paid on such claims if the estate of the debtor were liquidated under Chapter 7 of this title on such date, *and such plan represents the debtor's bona fide effort* [emphasis added].[67]

Although the House and Senate were in "almost complete agreement" on the technical amendments bill, differences over the amount of retirement for bankruptcy judges prevented its enactment in the 1980 congressional session.[68] As of this writing it is expected that the technical amendments bill will be introduced in Congress shortly, and that it will contain the "good faith effort" provision or equivalent language.

Although the language of the proposed amendments was ambiguous as to whether the "substantial payments" test of section 1325(a)(3), as that section has been read by a majority of the bankruptcy courts, would remain viable, the legislative history makes clear that it would not:

> In short, the "good faith" test looks to the present and future ability of the debtor to make payments into the chapter 13 creditor's fund during the course of the plan, while the traditional "good faith" test examines the intentions of the debtor and the legal effect of the confirmation of a chapter 13 plan in light of the spirit and purposes of chapter 13.
>
> . . .
>
> Moveover, subsection 1325(a)(3), as amended, neither prescribes nor authorizes the imposition by the court of a requirement that a chapter 13 plan propose any arbitrary minimum percentage or amount to creditors.
>
> . . .
>
> Under these criteria, the circumstances of a given case may require that the court confirm a chapter 13 plan which proposes no dividend whatever to holders of allowed unsecured claims. . . . [69]

67 CONG. REC. S15,170 (daily ed. Dec. 1, 1980).

68 CONG. REC. S15,1944 (daily ed. Dec. 9, 1980) (remarks of Sen. DeConcini).

69 H.R. REP. No. 96-1195, 96th Cong. 2d Sess. 138 (1980).

For purposes of this Article, the "proposed 'good faith effort' test" will refer to the above technical amendments bill and its legislative interpretation.

IV. Some Problems in Interpreting the Proposed "Good Faith Effort" Test

Despite the substantial legislative history concerning the proposed "good faith effort" test, very important ambiguities remain. For example, would the debtor be required to apply his property to the repayment effort? The debtor's ability to keep his non-exempt property has been touted as one of the advantages of chapter 13,[70] but the legislative history of the Bankruptcy Code of 1978 suggests that such a right exists only where the debtor proposes full repayment of his debts.[71] This interpretation of the present chapter 13 is consistent with the emphasis in the legislative history of the proposed "good faith effort" test:

> This provision will require the court to determine . . . that the proposed plan contemplates a "good faith" effort by the debtor in terms of the promised future payments as measured by the *ability* of the debtor to make such payments [emphasis in original]. The purpose of the "good faith effort" test . . . is to prevent the use of chapter 13 composition plans by debtors having a demonstrated ability, but not the willingness, to make whatever payments their particular circumstances reasonably permit over and above their primary obligations to support themselves and their dependents during the extension period.[72]

In determining whether chapter 13 debtors may retain their non-exempt property and yet comply with the proposed "good faith effort" requirement, the courts will find that they are on

70 *E.g.*, In re Barnes, 5 B.R. 376 (B.C.D.C. 1980); In re Henry, 4 B.R. 220, 223 (B.C.M.D. Tenn. 1980) (debtors may retain their property by agreeing to repay creditors); Wickham, *Chapter 7 or Chapter 13: Guiding Consumer Debtor Choice Under the Bankruptcy Reform Act*, 58 N.C.L. Rev. 815, 822.

71 H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 118 (1977):

> The benefit to the debtor of developing a plan of repayment under Chapter 13, rather than opting for liquidation under Chapter 7, is that it permits the debtor to protect his assets. In a liquidation case, the debtor must surrender his non-exempt assets for liquidation and sale by the trustee. Under Chapter 13, the debtor may retain his property by *agreeing to pay his creditors* (emphasis added).

72 H.R. Rep. No. 96-1195, 96th Cong., 2d Sess. 25 (1980).

the horns of a dilemma. If they do not require debtors to apply non-exempt property to the payment of debts, those whose wealth is in property will keep their wealth, while those whose wealth is in future earnings must surrender theirs — an obvious inequity. If the courts do require chapter 13 debtors to apply non-exempt property to the payment of debts, debtors with substantial non-exempt property can be expected to avoid the requirement by filing under chapter 11 instead of chapter 13. Debtors who are eligible to file for "adjustment of debts" under chapter 13 are also eligible to file for "reorganization" under chapter 11;[73] and, although the chapter 11 requirements for confirmation of a plan are more complex, for the debtor with substantial non-exempt property they will probably be less stringent than the requirements of chapter 13. At a minimum, the debtor would need the affirmative vote of only a single class of creditors[74] for a plan which offers creditors at least what they would get in chapter 7[75] and is "fair and equitable."[76] While the latter requirement is admittedly open-ended, it is generally understood to require only that creditors be assured an amount equal to the value of the debtor's business as of the time of reorganization, not that the debtor share his future earnings with creditors.[77] Further, chapter 11 has no equivalent of the "good faith effort" test.

Chapter 11 is not, however, a practical alternative for all chapter 13 debtors. Its higher filing and attorneys' fees would effectively exclude many less-affluent chapter 13 debtors.[78] Moreover, chapter 11 was designed primarily with business debtors in mind. If consumer debtors should begin filing under chapter 11 in substantial numbers, it will be apparent to the courts that they have done so to avoid the proposed "good faith effort" requirement, and it will not be difficult for the courts

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73 Bankruptcy Code § 109, 11 U.S.C. § 109 (Supp. III 1979).

74 Bankruptcy Code § 1129(a)(10), 11 U.S.C. § 1129(a)(10) (Supp. III 1979).

75 Bankruptcy Code § 1129(a)(7)(A), 11 U.S.C. § 1129(a)(7)(A) (Supp. III 1979) and Bankruptcy Code § 1129(b)(2)(B)(i), 11 U.S.C. § 1129(b)(2)(B)(i) (Supp. III 1979).

76 Bankruptcy Code § 1129(b)(1), 11 U.S.C. § 1129(b)(1) (Supp. III 1979) ("fair and equitable" requirement applies only if plan is "crammed down" on at least one class of dissenting creditors).

77 *See generally* 5 COLLIER (15th ed.), *supra* note 14, at ¶ 1129.03.

78 The filing fee under chapter 13 is $60 whereas under chapter 11 it is $200. 28 U.S.C. § 1930 (Supp. II 1978). Higher attorney fees can also be expected since chapter 11 is more cumbersome. H.R. REP. No. 95-595, 95th Cong., 1st Sess. 320 (1977).

to find justification to deny confirmation of their plans.[79] Thus the effect of a requirement that chapter 13 debtors apply their non-exempt property to the payment of debts would probably be to discriminate against the less-affluent consumer debtors who cannot shift to chapter 11.

This discrimination, however, pales beside the inequity which would result if the courts exclude exempt property from the proposed "good faith effort" requirement. All states have statutes providing that certain property is exempt from the legal processes available to creditors. These "exemptions" have been incorporated into the bankruptcy laws so that property of the debtor which could not have been seized on behalf of creditors on the date of filing the bankruptcy petition, is thereafter the property of the debtor, free from the claims of unsecured creditors.[80] The nature and potential value of the property which is exempt varies tremendously between states. For example, in Connecticut the debtor's home is not exempt,[81] whereas in Florida a "head of a household's" home, outside city limits, is exempt to the extent of 160 acres without limitation as to its value.[82] The Bankruptcy Code attempts to reduce this inequity by offering the debtor a choice between the exemptions available under the laws of his state or a generous "federal exemption" contained in the Bankruptcy Code.[83] The states were given the option to reject the federal exemption by state statute, however, and many have done so.[84] The unevenness of the exemption laws is further compounded by the continuation under the Bankruptcy Code of the "exempt" status of property held in tenancy by the entireties when only one spouse has filed bankruptcy.[85] Thus, depending upon the circumstances of the debtor,

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79 Not only could the courts refuse to "cram down" the consumer's plan as not "fair and feasible," it could reject it as not having been "proposed in good faith," an as yet unconstrued requirement of chapter 11. Bankruptcy Code § 1129(a)(3), 11 U.S.C. § 1129(a)(3) (Supp. III 1979).

80 Bankruptcy Act § 6, 11 U.S.C. § 24 (1976); Bankruptcy Code § 522, 11 U.S.C. § 522 (Supp. III 1979).

81 CONN GEN. STAT. ANN. § 52-352a to 52-352c (West).

82 FLA. CONST. art. X, § 4.

83 Bankruptcy Code § 522, 11 U.S.C. § 522 (Supp. III 1979).

84 *E.g.*, ARIZ. REV. STAT. ANN. § 33-1133.B; FLA. STAT. § 222.20; LA. REV. STAT. ANN. § 13:3881; OHIO REV. CODE ANN, § 2329,662; TENN. CODE ANN. § 26-2-112; VA. CODE § 34-3.1.

85 Bankruptcy Code § 522(b)(2)(B), 11 U.S.C. § 522(b)(2)(B) (Supp. III 1979).

he may shed his debts in bankruptcy and emerge as either a millionaire or a pauper.

Section 522 of the Bankruptcy Code, which incorporates into the Bankruptcy Code the exemption laws of the various states, applies under chapter 13,[86] and hence chapter 13 debtors are entitled to the benefits of the exemption laws. If, however, the proposed "good faith effort" requirement and its "willingness to pay in accord with ability" test is subject to an exception for exempt property, the legitimacy of the proposed test has surely been destroyed. It is absurd to say that a debtor who proposes payment of only 5 percent of his $100-a-week wages to creditors is not making a good faith effort in accordance with his ability, and then say that the owner of an exempt 160-acre country estate who refuses to sell off a few acres to pay his creditors in full is doing so. Thus, if exempt property is excluded from the proposed "good faith effort" test, the test requires neither "good faith" nor "effort" in any ordinary sense of these words.

A second interpretational problem that will confront the courts when the proposed "good faith effort" requirement is adopted, is to determine the level of effort that the debtor must make. The Senate initially determined that the debtor should make his best effort" and the payments should be "the greatest that the debtor can reasonably pay."[87] That the House of Representatives changed that language seems to suggest that a "good faith effort" must be something less. The House report on the 1980 technical amendments bill describes the test in terms very similar to the Senate description of "best efforts":

> The "good faith effort" test is not to be employed as a means of extracting from the debtor more future payments, either in number or amount, than the debtor can reasonably be expected to make during the normal three-year extension period.
>
> The purpose of the "good faith effort" test . . . is to prevent the use of chapter 13 composition plans by debtors having a demonstrated ability, but not the willingess, to make *whatever payments their particular circumstances reasonably permit* over and above their primary obligations to

86 Bankruptcy Code § 103(a), 11 U.S.C. § 103(a) (Supp. III 1979).
87 S. REP. No. 96-305, 96th Cong., 1st Sess. 97 (1979).

> support themselves and their dependents during the extension period [emphasis added].[88]

If every debtor would have to "make whatever payments his particular circumstances reasonably permit," it follows that the level of effort required would not be much less than the debtor's best.

It seems reasonably clear that the proposed "good faith effort" test looks to the objective result of the debtor's effort, and not to his subjective state of mind. Were it not so, the "good faith effort" test would be redundant since the "good faith" test of section 1325(a)(3) already tests the bona fides of the debtor's state of mind in proposing his plan. The legislative history of the 1980 bill confirms this interpretation when it states that the debtor must make "whatever payments [his] particular circumstances *reasonably* permit."[89] The element of reasonableness implies an objective standard.

To date, Congress has not indicated how it would quantify the objective standard. Congress has indicated that the debtors' "obligations to support themselves and their dependents" are "primary,"[90] but Congress did not try to answer the substantive question of how well they may be supported. The courts will need an answer to this question when the proposed "good faith effort" requirement is adopted. Consider the variety of possible answers.

First, the courts may be tempted to permit the debtor to continue his existing standard of living. This approach is consistent with the policy of the exemption laws which endeavor to allow the debtor and his family to continue living in the house they occupy.[91] This approach would work well in cases where the debtor's financial difficulties are solely the result of a temporary interruption of income, perhaps from disability or unemployment, which has been subsequently remedied. The shortcomings of this approach, however, become apparent when it is applied in the case of the debtor whose financial difficulty

88 H.R. REP. No. 96-1195, 96th Cong., 2d Sess. 25 (1980).

89 *Id.*

90 *Id.*

91 *E.g.*, Bankruptcy Code § 522(d)(1), 11 U.S.C. § 522(d)(1) (Supp. III 1979); FLA. CONST. art. X, § 4 ("upon which the exemption shall be limited to the residence of the owner or his family").

has resulted from failure to reduce his standard of living as inflation reduced his income. This debtor must reduce his standard of living simply to avoid going further into debt, and perhaps he should reduce it more to allow for some payment to creditors. Faced with debtors who have established widely differing standards of living on the same income, courts would likely conclude that fairness requires a standard of living applicable to all, regardless of past levels of expenditures.

Second, the courts might apply an entirely objective standard to the process of budget review, permitting the debtor to make only those expenditures necessary to support a particular standard of living. The standard of living, under this approach, would be the same for debtors regardless of their incomes. The standard of living of debtors, not the level of budget expenditures, would remain constant under this approach. To illustrate, courts might approve higher levels of expenditures for debtors with large families, or lower levels for debtors who need to make only a small monthly outlay for housing because they own their own homes.

The rationale for this approach would be that all debtors who seek the protection of the courts under chapter 13 have overcommitted their incomes for the next three years. The dollars which would provide the debtor an improvement in his standard of living should properly be viewed as coming from the pockets of creditors and not from the debtor's already overcommitted income. There is no reason why the creditors of high-income debtors should be required to make greater sacrifices than the creditors of low-income debtors.

While there is considerable logic in this argument, this "uniform standard of living" approach would be a radical departure from the very inegalitarian philosophy of the debtor relief system. For example, the exemption laws endeavor to allow debtors to retain all or certain items of property which is owned at the time of bankruptcy. Where dollar value limitations are imposed, they are not limitations on the value of the property, they are only limitations on the value of the debtor's equity in the property.[92] Provided that the proper mortgages are in place,

92 *E.g.*, Bankruptcy Code § 522(d), 11 U.S.C. § 522(d) (Supp. III 1979) ("debtor's aggregate interest, not to exceed $7500 in value, in real or personal property that the debtor . . . uses as a residence").

the law allows the debtor to keep even the most luxurious home or automobile, thereby implicitly assuming that the debtor's standard of living after bankruptcy will approximate what it was when he purchased the home.

In addition, the "uniform standard of living" approach would be unworkable without coordinated changes in the entire debtor relief system. For example, if the courts adopted this approach only in chapter 13, debtors with higher incomes could simply file under chapter 7 or chapter 11 where their incomes over the next three years are implicitly considered to be their own.[93] In short, it seems highly unlikely that any court would adopt so radical an approach.

It is more likely that courts will go to the opposite extreme and assume that the debtor's needs, and hence his ability to pay, are primarily a function of his take-home pay. One variation of this approach is embodied in the *Curtis* rule-of-thumb that, absent exceptional circumstances, the debtor should offer creditors 10 percent of his take-home pay.[94] The divorce courts already entertain the presumption that ability to pay is primarily a function of take-home pay, and the widespread use of take-home-pay "rules-of-thumb" in determining levels of alimony and child support adequately attest to their workability.[95] A major advantage of this approach is that it is easy to administer since the presumptive amount the debtor must pay is derived by applying a mathematical formula to an easily verifiable amount. The burden would be shifted from the court to the debtor or creditors to demonstrate why the result would be inappropriate in a particular case.

Aside from its inherently inegalitarian assumption that take-home pay should be the primary determinant of need, the only major drawback in this approach is that it would be, like its correlate in family law, effective in producing substantial payments in the large majority of cases. For example, under the

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93 *See* text accompanying notes 73 to 77 *supra*.

94 In re Curtis, 2 B.R. 43, (B.C.W.D. Mo. 1979).

95 Like the Bankruptcy Courts under chapter 13, in setting child-support levels the domestic relations courts are "limited to existing conditions and financial ability" to pay. 27B C.J.S. *Divorce* § 319(5), at 612 (1959). But the practical result is that levels of support are largely determined solely upon the basis of the payer's take-home pay, and many practice manuals contain charts showing the relationship. For an example *see* [1979] FAM. L. REP. (BNA), Reference File, at 513:0004-05.

Curtis rule-of-thumb the total payments over three years to creditors under a typical chapter 13 plan would be about 30 percent of the debtor's annual income. If debtors who seek relief in the bankruptcy courts typically owe unsecured debts of between 50 and 100 percent of their annual income,[96] a "good faith effort" might, on the average, require repayment of about 40 percent of the unsecured debt.[97] Only two courts that have adopted the "substantial payments" test would require more.[98] This "success" in exacting payments is referred to as a drawback because its effect is to magnify the inequities inherent in requiring a "good faith effort" of chapter 13 debtors as discussed in parts VI and VII of this Article.

Finally, the courts might determine the debtor's needs by examining the debtor's budget and determining the reasonableness of each item in light of the debtor's circumstances. This kind of review is suggested by the past congressional reference to the debtor's needs as being "primary."[99] This approach, however, would not furnish a comprehensive standard for determining permissible expenditures but would necessitate that standards be developed for each budget item. Rather than determining how well the debtor may live, the court would be faced with determining how well he may eat and dress and where he may live.

In some instances, the reasonableness of a particular budget item may seem intuitively obvious to a court. For example, the court in *In re Manning*[100] refused confirmation of a plan, suggesting that the debtors should rent out their upstairs apartment and move their college-age children downstairs where they would not have separate bedrooms. Most courts, however, seem to have recognized that any attempt to control particular expenditures would lead them into a jungle of policy issues from which they would not emerge. For example, should a debtor

96 *See* COMMISSION REPORT, *supra* note 2, at 44.

97 A debtor with an income of $10,000 annually would be expected to have indebtedness of 50 to 100 percent of that amount. Using the average of 75 percent, he would owe, on the average, $7500. Over three years he would be expected to pay 30 percent of $10,000, or $3000. The amount paid, $3000, is 40 percent of the amount owed, $7500.

98 In re Raburn, 4 B.R. 624 (B.C.M.D. Ga. 1980); In re Burrell, 2 B.R. 650 (B.C.N.D. Cal. 1980), *rev'd*, 6 B.C.D. 360 (N.D. Cal. 1980).

99 H.R. REP. No. 96-1195, 96th Cong., 2d Sess. 25 (1980).

100 5 B.R. 387 (B.C.W.D.N.Y. 1980).

be compelled to resign her membership in church organizations to save the dues money for creditors?[101] Should a debtor who takes home only $125 a week be permitted to retain a $4200 automobile purchased shortly before filing?[102] Should debtors be permitted to plan for and have additional children during the period of the plan? Or should a debtor whose profession is selling real estate be permitted to purchase a new Mercedes Benz because it will give him the appearance of success and thereby help him earn more money?

The impracticality of the "budget item" approach becomes obvious when one considers that during the first six months the Bankruptcy Code was in effect, 29,142 petitions were filed under chapter 13,[103] an average of more than 24 per bankruptcy judge per month. Budget review is only one of many duties the court performs in each chapter 13 proceeding, and chapter 13 proceedings are only a fraction of the business of the bankruptcy courts, so the judicial manpower to implement an effective "budget item" approach is not presently available.

Because of the practical limitations on their ability to perform detailed budget reviews, bankruptcy courts would probably do so only when objections were raised by creditors or the trustee. Such objections would be raised only in cases where particular budget items are clearly excessive, since creditors would want to avoid controversy over very small amounts of money.[104] Thus, the well-advised debtor who spreads his "excesses" evenly throughout his budget could, under the "budget item" approach, expect to obtain confirmation of a plan that proposes relatively small payments to unsecured creditors. If he later spends his income differently, it would probably escape the attention of the court. Thus, a court which adopts a "budget

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101 *See* In re Cadogan, 4 B.R. 598 (B.C.W.D. La. 1980) (debtor advised by the court that $120-per-month dues was excessive).

102 *See* In re Ryals, 3 B.R. 522, 524 (B.C.E.D. Tenn. 1980) (the court permitted it, saying: "The court must hesitate at imposing on a debtor its idea of what sacrifices, other than financial, he should make in order to pay his creditors").

103 ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, FEDERAL JUDICIAL WORKLOAD STATISTICS A-53 (for the 12-month period ended Mar. 31, 1980).

104 Creditors will be constrained by the fact that they must pay their own attorney fees. Seldom could those fees qualify for reimbursement as administrative expenses. *See* Bankruptcy Code § 503(b), 11 U.S.C. § 503(b) (Supp. III 1979). Private trustees are generally compensated on the basis of a fixed percentage of payments made. *E.g.*, In re Blackwell, 5 B.R. 748, (B.C.W.D. Mich. 1980).

item" approach to application of the "good faith effort" test would, in practical effect, be adopting a relaxed view of the "good faith effort" test and would seldom exact substantial payments from chapter 13 debtors.

To summarize, when the proposed "good faith effort" test is enacted, only courts that adopt a rule-of-thumb presumptively linking the debtor's needs to his take-home pay, will be consistently able to exact substantial payments from debtors. Some courts will undoubtedly be influenced by the fairness of the "uniform standard of living" approach, but this approach will remain only a moderating influence so long as the debtor-relief system remains essentially inegalitarian. Reference to the debtor's previous standard of living will probably be used selectively by courts as a means of establishing a minimum amount which debtors can pay to their creditors, but its ineffectiveness in establishing a maximum amount is easily apparent. Finally, the review of individual budget items will leave courts without standards to police effectively the debtor's proposed expenditures.

Considering that relatively small amounts of money are involved and that courts must rapidly decide large numbers of cases, when the proposed "good faith effort" requirement is adopted, there will be substantial pressure on the courts to adopt simple, objective guidelines for determining whether debtors have made "good faith efforts." Those courts which desire to exact substantial payments from debtors will probably adopt rules-of-thumb presumptively linking the debtor's needs to his take-home pay. Those courts which do not wish to exact substantial payments can adopt a "budget item" approach without guidelines, and merely respond to the objections of creditors and trustees.

V. The Proposed "Good Faith Effort" Requirement from the Debtor's Perspective

Congress designed chapter 13 primarily for the debtor who wants to pay his debts, and thereby avoid the stigma of bankruptcy.[105] The following discussion will refer to such a debtor as the "willing debtor." Congress, however, in discussing the

105 *See* H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 117-18 (1977).

technical amendments bill of 1980, was concerned with the "reluctant debtor," an individual who would not otherwise undertake a repayment plan, but who might be "encouraged" to do so by a statutory scheme:

> Chapter 13 is designed to induce eligible debtors to repay their just obligations from future income, as a means of avoiding the waste, hardship and social and economic disruptions usually attendant upon liquidating bankruptcy proceeding under chapter 7. The principal statutory inducments to chapter 13 debtors include the legal protections afforded debtors from creditor action during the pendency of the plan, the broadened reach of the chapter 13 discharge, as well as the enhanced availability of future discharge relief under the Bankruptcy Code, and the retention by the debtor of property of the debtor and property of the estate during the extension period. These and other important legal and economic advantages are afforded to chapter 13 debtors, but not chapter 7 debtors.[106]

By examining the effect of the proposed "good faith effort" test upon the "willing debtor" and its effect upon the "reluctant debtor," the problems with the test can be revealed.

A. *The Willing Debtor*

From the standpoint of the "willing debtor" the most dramatic effect of passage of a technical amendments bill such as the one before Congress last term would be that chapter 13 would be available regardless of ability to pay. The House of Representatives noted that under the "good faith effort" criterion, "the circumstances of a given case may require that the court confirm a chapter 13 plan which proposes no dividend whatever to holders of allowed unsecured claims. . . ."[107] The new criterion would abrogate the "substantial and meaningful payments" test, and such judicial corollaries as: "We must avoid the notion that [chapter 13] was intended for all. Some debtors, from either lack of sufficient desire or lack of sufficient means will be left to chapter 7 for relief from their debts,"[108] and "Congress has recognized that chapter 13 may not be within

106 H.R. REP. No. 96-1195, 96th Cong., 2d Sess. 25 (1980).
107 *Id.*
108 In re Cook, 3 B.R. 480, 486 (B.C.S.D. W.Va. 1980).

the capabilities of all debtors, and . . . the courts should not do less."[109] However, by making chapter 13 available to more debtors, and encouraging its use by "reluctant debtors," chapter 13's usefulness to the "willing debtor" would be greatly reduced as chapter 13's relatively stigma-free status would erode.

Congress has never indicated that it desires to abandon the concept of a relatively stigma-free chapter 13. Presumably, supporters of the proposed "good faith effort" test believe that allowing some less fortunate debtors, those who cannot afford to make substantial payments to unsecured creditors, the benefits of chapter 13 will not infuse a substantial stigma into chapter 13 so long as the bankruptcy courts assure that those less fortunate debtors each make "whatever payments their particular circumstances reasonably permit."[110] In other words, the credit community should not stigmatize a debtor who does not have the ability to pay more.

However, this reasoning errs in considering a debtor's efforts made after filing the chapter 13 petition, while ignoring the important relationship between a debtor's inability to pay his debts and his possible pre-filing misconduct. This relationship may be illustrated by considering three possible scenarios which may have brought the debtor to the bankruptcy court. In the first, the debtor, as a result of a minor misjudgment as to his ability to make payments or a temporary interruption of that ability, falls behind in his payments. Although he is willing and able to pay his debts, one of his creditors refuses to extend his payment time, obtains a judgment, and garnishes the debtor's wages. The debtor files under chapter 13, and proposes and makes full repayment. In this scenario, the credit community would likely regard the debtor as a victim of circumstances, and not attach serious stigma to the proceeding. The proposed repayment, in full, is evidence that the debtor's miscalculation was minor; the fact that it was made attests to the debtor's lack of ulterior motives. The debtor from this scenario will be referred to as the Able Debtor.

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109 In re Goeb, 4 B.R. 735, 737 (B.C.S.D. Cal. 1980).

110 H.R. REP. No. 96-1195, 96th Cong., 2d Sess. 25 (1980).

In the second scenario, the debtor had the ability to pay his debts when incurred, but lost that ability afterwards through no fault of his own. While this debtor cannot offer creditors a payment substantial in relation to his debts, his conduct has not been blameworthy; the credit community might not regard this situation as warranting serious stigma. The debtor from this scenario will be referred to as the Unfortunate Debtor.

In the third scenario, the debtor suffers no unexpected financial reverses, but through carelessness or wrongful intention incurs debt substantially beyond his ability to pay. This debtor was not a victim of circumstances and the substantial difference between what he owes and what he can pay and the absence of unforseeable financial reverses, justify the conclusion that he was blameworthy in dealing with creditors before filing the chapter 13 petition. The debtor from this scenario will be referred to as the Blameworthy Debtor. Presumably, the credit community will want to attach stigma to the Blameworthy Debtor. Yet, the Blameworthy Debtor's misconduct prior to filing under chapter 13 is seemingly rewarded under the proposed "good faith effort" test which ignores the relationship between inability to pay and pre-filing misconduct.

Under the current "substantial payments" test, both the Blameworthy and the Unfortunate Debtors are excluded from chapter 13. Arguably, the Unfortunate Debtor has been unjustly treated because the credit community probably sees no need to stigmatize him. However, under the proposed "good faith effort" test, all three debtors are eligible to file under chapter 13. The inclusion of the Blameworthy Debtor in a purportedly stigma-free proceeding is inappropriate and his presence can be expected to seriously impair the stigma-free status of chapter 13. In short, whereas the "substantial payments" test arguably circumscribes chapter 13 too narrowly, the proposed "good faith effort" test opens chapter 13 to an excessively large class of debtors.

In order to realize the objective of a relatively stigma-free chapter 13, the law ideally should distinguish the Unfortunate from the Blameworthy Debtor. Practically, however, this distinction would be extremely difficult for the bankruptcy courts to make. Determining blameworthiness would often require re-

constructing a debtor's financial affairs for months, and in some cases years, before filing. The court would have to know what the debtor knew, and when he knew it; such an inquiry would consume substantial resources. In this regard, the inquiry would be analagous to that made when a debt is alleged to be non-dischargable by reason of fraud. Bankruptcy courts have, in general, found this latter inquiry to be difficult and extremely time consuming.[111] Indeed, one bankruptcy court has commented that requiring a non-dischargeability hearing before confirmation "would lead to immediate and dire constipation of the court's chapter 13 proceedings. . . ."[112]

The blameworthiness inquiry would be even more troublesome. First, while inquires into non-dischargeability are necessary in relatively few cases because fraud is relatively uncommon, blameworthiness hearings would examine more common behavior, and therefore would be required in a larger number of cases. Second, in determining dischargeability, the court is generally under no urgent time constraint.[113] However, if a determination that the debtor was not blameworthy was required for chapter 13 relief, the court would be forced to decide the issue more quickly because blameworthiness would determine whether the debtor should be making, and the creditors receiving, payments from the debtor's post-petition earnings. In the meantime, the debtor would enjoy the protections of chapter 13, such as the co-debtor stay and the right to retain collateral without making a prompt cash redemption. These benefits might induce blame-worthy debtors to file under chapter 13, since the delay necessary to determine blameworthiness might well prove substantial. Even if the debtor were required to make chapter 13 payments during this interim period, the payments could not be forwarded to creditors who might later be found not entitled to them.

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111 *See* In re Jenkins, 4 B.R. 278, 279 (B.C.D. Colo. 1980); In re Marlow, 3 B.R. 305, 306 (B.C.N.D. Ill. 1980).

112 In re Jenkins, 4 B.R. 278, 279 (B.C.D. Colo. 1980).

113 In chapter 7 the determination of dischargeability will have no effect upon distribution of the estate, since there is no priority given to the holder of a non-dischargeable debt. In chapter 13 the determination of dischargeability is seldom required in fraud cases, because debts incurred by fraud are dischargeable if the debtor completes payment under a confirmed plan. Bankruptcy Code § 1328(a), 11 U.S.C. § 1328(a) (Supp. III 1979).

It is also unclear if one could theoretically differentiate the blameworthy and non-blameworthy debtors. Standards of appropriate debtor conduct have not been developed and it is doubtful that a clear line between appropriate and blameworthy credit practices can be developed.[114] Debtors would more readily fall along a spectrum of blameworthiness than into discrete categories.

Finally, the very inquiry into blameworthiness would render the debtor-relief process less attractive to debtors, thereby discouraging its use. Though inquiries regarding blameworthiness might be confined to chapter 13 cases, they would affect all of bankruptcy law; the credit community might presume, for example, that a chapter 7 debtor who had foregone the more favorable relief available under chapter 13 had done so to avoid an inquiry which would have found him blameworthy. Approximately 99.5 percent of all debtor-relief proceedings are filed voluntarily.[115] Since the debtor-relief system functions only to the extent that debtors are attracted to it, it would be a grave mistake to discourage voluntary use of the process.[116]

Given the difficulty of distinguishing the Unfortunate Debtor from the Blameworthy Debtor, the proposed legislation would allow chapter 13 relief to both. By permitting the Blameworthy Debtor to use chapter 13, however, the steady erosion, if not the immediate collapse, of chapter 13's relatively stigma-free status would be assured. For the willing debtor, stigma avoidance and not the "opportunity to pay creditors" is the essence of chapter 13 relief. Such a debtor has the alternative of filing under chapter 7, and after obtaining a discharge, paying his creditors according to his own schedule and ability, without interference from creditors and without fear of a creditor's claim that the debtor has reaffirmed the debt.[117] This was apparently a common practice under the Bankruptcy Act, and encouraged

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114 Unlike the defendant in the typical automobile negligence case, the typical debtor arrives at his predicament as the result of a series of complex and value-laden choices.

115 ADMINISTRATIVE OFFICE OF THE UNITED STATES COURTS, FEDERAL JUDICIAL WORKLOAD STATISTICS, A-52 to A-53 (for the 12-month period ended Mar. 31, 1980).

116 For a general discussion of why the debtor-relief system should attract voluntary filings, *see* COMMISSION REPORT, *supra* note 2, at 68-74.

117 A reaffirmation is ineffective unless made at or before the discharge hearing. Bankruptcy Code § 524(c)(1), 11 U.S.C. § 524 (c)(1) (Supp. III 1979).

by some referees.[118] The primary benefit chapter 13 has to offer this debtor, other than its more generous relief, is the "chapter 13" label. To the extent that chapter 13 plans, offering low or no payments from the Blameworthy Debtor, are proposed and confirmed, the stigma attached to chapter 13 would increase, while the value of the chapter 13 label would decrease. This trend would be reinforced to the extent that the credit industry and public became aware that chapter 13 was the only chapter which provided a discharge to the debtor who incurred his obligations through fraud, embezzlement, or willful tort;[119] and the stigma associated with filing under chapter 13 would approach and possibly exceed that of filing "straight bankruptcy." Chapter 13 would then cease to fulfill a major purpose for which it was created.[120]

B. *The Reluctant Debtor*

The "reluctant debtor" is an individual who is "encouraged" to undertake a chapter 13 repayment plan rather than filing under chapter 7 even though his focus is upon obtaining a fresh start with few obligations. Consider two possible examples of "reluctant debtors." First, a debtor who owns a $3,000 automobile, against which he owes a debt of $4,000, wishes to keep the automobile because he is unable to obtain the credit necessary to replace it. If at the time of commencing a chapter 7 case, he is in default and the payments have been accelerated, he must surrender the automobile, negotiate a reaffirmation acceptable to both the creditor and the court, or pay for the automobile in one lump sum. Under chapter 7, the court cannot

118 *See* COMMISSION REPORT, *supra* note 2, at 158-61.

119 *Compare* Bankruptcy Code § 523(a), 11 U.S.C. § 523(a) (Supp. III 1979) *with* Bankruptcy Code § 1328(a), 11 U.S.C. § 1328(a) (Supp. III 1979).

120 Perhaps the goal of a relatively stigma-free chapter 13 is not realistic. Most chapter XIII plans were extension plans in which the debtor proposed repayments in full. Very few composition plans were filed. *See* Perry v. Commercial Loan Co., 383 U.S. 392, 395 (1966). Even so, the percentage of debtors receiving credit after chapter XIII was not markedly higher than after bankruptcy. D. STANLEY & M. GIRTH, BÅANKRUPTCY: PROBLEM, PROCESS, REFORM 64 (1971). Bankruptcy courts could assit able debtors in avoiding stigma by making the percentages of repayments conveniently available on the record. The credit reporting community is already inclined to report the percentages of repayments proposed in chapter 13 cases, suggesting that this is the type of information the credit-granting community desires.

require that the secured creditor accept installment payments,[121] and it would be a rare debtor who could redeem the automobile in cash.[122] Thus, if the debtor cannot negotiate and obtain court approval of a reaffirmation agreement, there can be no relief under chapter 7.[123]

However, it is only in the very unlikely event that the creditor agreed to reduce the amount of the debt to the value of the collateral ($3,000), that a court would approve the reaffirmation of the debt under chapter 7. Section 524(c) of the Bankruptcy Code provides that such a debt may only be reaffirmed if the court approves the reaffirmation as being "in the best interest of the debtor."[124] This language has been interpreted to mean that, where a debtor reaffirms a debt for the purpose of retaining collateral, he may not agree to pay substantially more than the value of the collateral.[125] The purpose of the "best interest of the debtor" requirement is not to protect debtors from reaffirming debts they are unable to repay, but rather to assure that debtors have fresh starts unburdened by debt.[126]

Viewed from the perspective of our debtor, to whom the automobile is essential, his inability to reaffirm the automobile

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121 In re Zimmerman, 4 B.R. 739 (B.C.S.D. Cal. 1980); In re Miller, 4 B.R. 305 (B.C.E.D. Mich. 1980); In re Stewart 3 B.R. 24 (B.C.N.D. Ohio 1980); *but see* In re Iacovani, 2 B.R. 256, 265 n.2 (B.C.D. Utah 1980) (a chapter 7 debtor might be able to extend secured payments on otherwise exempt property upon a showing of adequate protection). The controversy on this point would have been laid to rest by section 63 of the technical amendments bill. H.R. REP. No. 96-1195, 96th Cong., 2d Sess. 19 (1980), explains that "[t]his Amendment makes it clear that the debtor's right of redemption can be effected in two different ways, one by executing a reaffirmation agreement under section 524 and the other by paying the creditor a lump-sum before the case is closed." *See generally* 11 U.S.C. § 722 (Supp. III 1979).

122 *See* General Motors Acceptance Corp. v. Miller, 4 B.R. 305, 307 (B.C.E.D. Mich. 1980).

123 *See* In re Vinson, 5 B.R. 32 (B.C.N.D. Ga. 1980).

124 11 U.S.C. § 524(c) (Supp. III 1979).

125 *See, e.g.*, In re Jenkins, 4 B.R. 651 (B.C.E.D. Va. 1980) (court refused to permit reaffirmation of a debt in the amount of $792.76 to retain $200 worth of collateral, implying that the debtor could find some less expensive solution to his problem); In re Blount, 4 B.R. 92 (B.C.M.D. Tenn. 1980) (court reviewed the legislative history before concluding that the debtor could not reaffirm an $1820.25 debt to retain an automobile worth $600); In re Avis, 3 B.R. 205 (B.C.S.D. Ohio 1980) (court refused debtor's application to reaffirm a cosigned debt, stating that the "intended meaning of a debtor's 'best interests' are strictly financial"); *but see*, In re McGunn, 6 B.R. 612 (B.C.E.D. Pa. 1980) (court permitted reaffirmation of $4,710 debt to retain $2,700 automobile and motorcycle stating that "an economic inquiry is not exclusive given a specific facual setting").

126 The requirement of 11 U.S.C. § 524(c) (Supp. III 1979) that the agreement must not propose an undue hardship on the debtor, insures that debtors do not reaffirm debts they are unable to pay.

loan under chapter 7 means that he must convert his case to chapter 13. This is but one way that chapter 7 rules "encourage" debtors to file under chapter 13. However, under the proposed "good faith effort" test, a payment schedule would be imposed under chapter 13 which would likely be more burdensome than that which chapter 7 seeks to prevent.[127] For example, the debtor might be required to pay $3,000 with interest to his automobile-loan creditor plus 10 percent of his take-home pay for three years to be shared by all creditors as opposed to paying $4,000 with interest to his automobile-loan creditor.

Second, consider a debtor who feels a strong moral obligation toward a co-debtor. Co-debtors are likely to be co-workers, relatives, or friends who have become obligors, often at the insistence of the creditor at the time of the extension of credit.[128] Under chapter 7, the debtor would be discharged from his obligation on the cosigned debt, and would be denied the opportunity to reaffirm it.[129] The creditor would then be permitted to immediately proceed against the co-debtor, since section 362's automatic stay does not apply to actions against co-debtors.[130] If the co-debtor is clearly solvent, it would probably be in the creditor's best interest to proceed against him, despite our debtor's assertion that he, the debtor, will voluntarily repay the debt without reaffirmation. Chapter 7 provides ineffective relief for our debtor who wants to repay his creditor, and fulfill his moral obligation to his friend or relative. Our debtor is thus forced to chapter 13, where he will be informed that, because section 1301 provides that creditors can get relief from the stay to the extent the debtor proposes less than full repayment,[131]

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127 The chapter 7 court would need to apply the "best interest of the debtor" test only in situations where the reaffirmation agreement would not impose a "hardship" on the debtor or his dependents. The language of the "hardship" test of Bankruptcy Code § 524(c)(4)(A)(i), 11 U.S.C. § 524(c)(4)(A)(i) (Supp. III 1979), is virtually identical to the language used in the legislative history to describe the limit of "good faith effort." *See* H.R. Rep. No. 96-1195, 96th Cong., 2d Sess. 25 (1980). Thus, chapter 13 has a maximum limit on payment almost identical to that in Bankruptcy Code § 524(c)(4), but without the "best interest of the debtor" requirement of the latter section which might reduce the payment below that maximum.

128 Commission Report, *supra* note 2, at 167.

129 *See* Bankruptcy Code § 524(c)(4)(A), 11 U.S.C. § 524(c)(4)(A) (Supp. III 1979) and In re Avis, 3 B.R. 205 (B.C.S.D. Ohio 1980).

130 11 U.S.C. § 362 (Supp. III 1979).

131 Upon application by the creditor, relief from the stay must be granted "to the extent that" the debtor proposes less than full repayment. Bankruptcy Code § 1301(c)(2),

the price of his moral convictions is full repayment of the cosigned debt. Thus, without apparent reason for distinction, chapter 7 prohibits our debtor from repaying the cosigned debt while chapter 13 encourages such repayment.

The House Committee on the Judiciary, in explanation of the proposed "good faith effort" test, stated that, "chapter 13 is designed to induce eligible debtors to repay their just obligations from future income, as a means of avoiding the waste, hardship, and social and economic disruptions usually attendant upon liquidating bankruptcy proceedings under chapter 7."[132] In the two situations described above, the debtor would encounter waste, hardship, and disruption in a chapter 7 proceeding, because necessary relief is unavailable under chapter 7. The waste, however, is not, as suggested by the committee report cited immediately above, inherent in the nature of a chapter 7 proceeding. The waste, hardship, and disruption is the deliberate result of Congress's decision to "encourage" the filing of chapter 13 repayment plays by withholding needed relief from chapter 7.

VI. Toward an Involuntary Chapter 13?

From time to time proposals have been made that a debtor who could obtain relief under chapter XIII should be denied relief in "straight bankruptcy."[133] These proposals were rejected by Congress in 1967,[134] by the Bankruptcy Commission in 1973,[135] and by Congress in 1977.[136] The belief in rejecting these proposals was, if the debtor-relief system attempts to involuntarily impose three-year repayment schedules out of future income, debtors will exercise that most ancient of debtors' remedies, "skipping town."[137] In that event, it is not only the debtor who is the loser because the repercussions are felt by creditors, employers, and the economy as a whole.

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11 U.S.C. § 1301(c)(2) (Supp. III 1979). The majority view is that a cosigned debt can not be separately classified. *E.g.*, In re Nickels, 4 B.R. 481 (B.C.S.D. Ohio 1980).

132 H.R. Rep. No. 96-1195, 96th Cong., 2d Sess, 25 (1980).

133 Commission Report, *supra* note 2, at 158.

134 *Id.*

135 *Id.* at 158-59.

136 H.R. Rep. No. 95-595, 95th Cong., 1st Sess. 120-21 (1977).

137 *Id.*

For many debtors, however, chapter 13 under the proposed "good faith effort" test would be as "involuntary" as the proposals which have been uniformly rejected by Congress. The chapter 13 debtor is not prohibited from electing chapter 7 as he would have been under the rejected proposals, yet the effect is the same in cases where relief under chapter 7 would be ineffective. For the debtor who needs relief which is available only under chapter 13, to the extent of the value of the relief, chapter 13 can be said to be "involuntary."[138] Whether this is of practical significance depends upon a combination of two factors: first, the essentialness of the relief available only under chapter 13, and second, the expense to the debtor of using chapter 13 instead of chapter 7. That the magnitude of these factors will vary tremendously from case to case demonstrates the fundamental unfairness underlying this scheme of bankruptcy relief.

Potentially, the need for the more generous relief of chapter 13 is great. Generally, consumer debtors are more dependent upon their ability to retain installment purchases when they file bankruptcy proceedings than they were in previous decades.[139] Cosignatories and home mortgages are both more common. However, the existence of need for the more generous relief of chapter 13 in particular cases is virtually random. While one debtor who has kept his automobile loan payments up to date may file chapter 7 and keep the automobile, another debtor, whose only mistake has been to treat his creditors alike, must pay the price of chapter 13 in order to retain his automobile. Similarly, one debtor may consider action by the creditor against his co-debtor acceptable while another may not. It is difficult to predict how often and how badly, "reluctant debtors" will need chapter 13 relief.

It is even more difficult to predict what chapter 13 relief will cost the debtor under the proposed "good faith effort" test. Two major issues would have to be resolved: the extent to which the debtor must apply his property to payment of creditors, and the determination of a test to measure the debtor's

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138 In re Moss, 5 B.R. 123, 125 n.4 (B.C.M.D. Tenn. 1980).

139 Since 1946, the amount of consumer credit outstanding has increased over twenty-fold. COMMISSION REPORT *supra* note 2, at 49.

ability to pay creditors from his income. Under the *Curtis* rule-of-thumb — that the debtor should pay 10 percent of his take-home pay to unsecured creditors — the price of chapter 13 relief would be steep. For a debtor earning $12,000 per year, chapter 13 relief would cost $3600 over a three-year period — far too great a premium to pay to retain an automobile. The adoption of such a rule-of-thumb is probably necessary to give substance to the proposed "good faith effort" test, but, at the same time, it also would give substance to the "involuntary" aspects of chapter 13.

If the courts, in interpreting the proposed "good faith effort" test, were to opt instead for the procedure of budget-item review, with a certain portion of the "excess" being paid to creditors, chapter 13 relief would probably be inexpensive; the involuntary aspects of chapter 13 would cease to be troubling. The proposed "good faith effort" test would eliminate from chapter 13 only the most blatant cases of "unwillingness to pay," and such debtors would be the ones who most deserve to suffer the rigors of chapter 7. One might object that the true function of the proposed "good faith effort" test, interpreted in this manner, would be to compel each debtor to claim affirmatively a need for his property and future income, thereby assuring that he will not become an example for the popular press of how debtors use bankruptcy proceedings to gain an unfair advantage over those who pay their debts.[140] Despite this objection, the "budget-item review" interpretation is preferable to one which would exact substantial payments, because it does not have great potential for deterring debtors from obtaining effective chapter 13 relief.

VII. Conclusions and Recommendations

The proposed "good faith effort" test represents a compromise between two competing conceptions of chapter 13. The conception expressed in the strict construction cases is that chapter 13 provides a means for debtors voluntarily to pay their

140 *E.g., King of Bankruptcy,* Time, July 14, 1975, at 40-41; *A Pot of Brass,* Newsweek, May 12, 1975, at 59 (discussion of extravagant spending); *Bankruptcy — No Longer a Dirty Word,* U.S. News and World Report, April 7, 1975, at 52-53.

creditors but offers them no tangible rewards for doing so. On the other hand, cases requiring "substantial payments" are grounded in the belief that a chapter 13 which is open to all regardless of willingness and ability to pay creditors, cannot offer debtors the essential element of chapter 13 relief — the opportunity to avoid the stigma of bankruptcy. The proposed "good faith effort" test is an attempt to steer a middle course by requiring chapter 13 debtors to pay their creditors, but not in an amount in excess of the debtor's ability to pay. Ideally this would assure that debtors pay what they could, but would not deny chapter 13 relief to anyone.

By steering this middle course, however, the worst of both conceptions would be realized. The debtor who is both willing and able to repay his creditors is left without the means to avoid the stigma of bankruptcy because chapter 13 would abound with zero- or nominal-payment plans. Yet the debtor who seeks only a fresh start with the opportunity to make payments on a fully-encumbered home or automobile, and is willing to incur the stigma of bankruptcy to get it, may be denied the relief he needs because it would be available only in chapter 13 and would be overpriced at that.

The proposed "good faith effort" requirement is an expression of the same concern which has produced each of the previous "involuntary chapter 13" proposals: debtors abuse the debtor relief system when they elect to pay creditors nothing from substantial future earnings. It is difficult to quarrel with the proposition that debtors *should* pay their debts to the extent that they are able. Whether the law should attempt to compel debtors to pay their debts to the extent they are able is a more complex issue. The legal sanctions available to compel such an attempt are limited. Experience with imprisonment for debt has shown that the use of criminal sanctions quickly becomes counterproductive. Furthermore, economic sanctions are ineffective in the chapter 13 context because the debtor's sole asset is often the very future earnings which the law seeks to reach. Chapter XIII, with the threat of the stigma of bankruptcy, was an example of the use of social sanctions to compel repayment. That policy enjoyed a measure of success, but the adoption of the proposed "good faith effort" test would sacrifice the success in favor of a more direct sanction for compelling debtors to

fulfill their moral duties — the denial of effective bankruptcy relief.

The proposed "good faith effort" test is actually a modest version of the "involuntary chapter 13" proposals which Congress has rejected in the past. The "involuntary chapter 13" proposals would have denied all bankruptcy relief to debtors who had the ability but not the willingness to pay creditors. Under the proposed "good faith effort" test, however, such debtors are denied only certain elements of bankruptcy relief — the relief available only in chapter 13. This limited attempt to compel repayment could seriously damage the credibility of the debtor-relief system, which has always sought to reduce the effect of its inequities by placing few demands on debtors, because the "good faith effort" test would arbitrarily impose its obligations. The inequities underlying the debtor-relief system are prodigious. Consider first the inequities which precede adoption of the "good faith effort" test. Practicalities prevent the debtor-relief system from distinguishing the Blameworthy from the Unfortunate Debtor, so both are treated alike. The exemption laws assure that propertied debtors fare better than those without property, and that propertied debtors in generous-exemption states fare better than properties debtors in other states. Finally, debtors are treated alike whether their debt exceeds their ability to pay by $50 or $50,000.

To this patchwork the "good faith effort" test would bring the requirement that certain debtors — those who *need* the relief available only in chapter 13 — must pay their creditors. No such requirement is placed on other debtors who wish to shed their debts, yet, at best, debtors fall into either category randomly. At worst, which category a debtor is in may depend upon how easily he can forget a cosigner's act of friendship.

Under the proposed legislation, the penalty which the debtor would pay for being in need of chapter 13 relief is a "good faith effort." The vagueness of that term assures that it would receive varying interpretations; and, the relatively small amounts of money involved in chapter 13 cases will discourage appeals and thereby retard the process of developing a uniform interpretation. It is clear, however, that the size of the penalty would not vary with the value of the relief, but rather with the debtor's ability to pay; thereby, a debtor is invited, before filing, to

manipulate his ability to pay. For example, the purchase of a new car before filing would insure that a debtor's efforts under chapter 13 would inure to his own benefit and not be used to repay unsecured creditors.[141]

Those debtors with substantial exempt property or future earning ability would probably escape the "good faith effort" test by filing under chapter 7. While they may be unable to retain their automobiles, they would be in a financial position to replace them afterwards. However, debtors who need their automobiles, and do not have the financial ability to replace them after bankruptcy, could refinance their automobiles under chapter 13 only by agreeing to meet the "good faith effort" requirement.

Even though the chapter 13 debtor is not required to pay more than he owes, he would likely resent being saddled with a three-year payment schedule when others pay nothing. This perception of unfairness could lead to cynicism and attempts to manipulate the system to the debtor's advantage. Possible effects would include higher administrative costs in policing involuntary repayment, increased attorney's fees as debtors struggle for what they regard as equal treatment, the economically wasteful repossession and resale of consumer goods which are surrendered by debtors who opt not to make a "good faith effort," and a worsening of the general repute of the debtor-relief system.

If the "good faith effort" requirement does injustice to some debtors, it can be argued that the lack of it does an even more serious injustice to some creditors. Creditors might argue that even though the "good faith effort" test would artibrarily select a group of debtors upon which to impose its burden, the selected debtors do owe the debt and do have the ability to pay it. The lack of a "good faith effort" requirement, on the other hand, releases debtors from their obligation to pay, and thereby injures innocent creditors.

This argument ignores an important difference in the effect of imposing burdens upon creditors instead of debtors. In chap-

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141 Presumably the car would be heavily financed. The debtor would propose to make the payments from his income, thereby committing funds which would otherwise be paid to unsecured creditors. Such a purchase was made and accepted by the Court in In re Ryals, 3 B.R. 522 (B.C.E.D. Tenn. 1980).

ter 13 situations, the avoided debt is held almost entirely by financial institutions which are in the business of extending consumer credit.[142] The loss does not come to rest with the lender, but is passed on to other consumer borrowers in the form of higher interest rates or more stringent borrowing requirements.[143] To the extent that the loss can be regarded as a product of the debtor-relief system's determination that it is not economical to attempt to distinguish between the Blameworthy and the Unfortunate Debtor, or "encourage" debtors to repay their debts, it is appropriate that the loss be borne by consumer borrowers generally. The loss is one of the prices of maintaining the integrity and workability of a system which any debtor might one day need.

Congress should not deny effective relief to debtors who desire only a fresh start and are unwilling to commit to a three-year "good faith effort" to pay their creditors. Nor is it necessary to do so to enable chapter 13 to avoid the stigma of bankruptcy. Congress can adopt the "good faith effort" test but at the same time give debtors who are eligible under chapter 13 but who file under chapter 7 the option to have the provisions of chapter 13, excluding the "good faith effort" requirement, apply to their cases. In effect, this would allow debtors the benefits of chapter 13 relief without the chapter 13 label. This would eliminate the need for the bankruptcy courts to choose between the public policies of granting effective relief to all debtors and maintaining a means for worthier debtors to avoid the stigma of bankruptcy. This would also open the way for Congress to later add a substantial-payments requirement to chapter 13, so that chapter 13 might actually attain its goal of stigma-free status.

If Congress adopts the proposed "good faith effort" requirement but elects not to make these changes, the bankruptcy courts could minimize the resulting inequities of the proposed "good faith effort" requirement by pressing softly in applying the test, allowing debtors to retain their property and future income conditioned only upon a plausible demonstration of a

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142 *See* COMMISSION REPORT *supra* note 2, at 44.

143 More stringent standards for borrowing would presumably tend to increase profits by decreasing bad-debt losses. Legislatures could, in turn, invite less stringent standards by increasing the usury rate.

reasonable need. This would give the bankruptcy process reasonable protection against the public image it apparently fears — a process in which laughing debtors are permitted to keep expensive homes and incomes while thumbing their noses at helpless creditors — while at the same time affording every eligible debtor effective bankruptcy relief.

NOTE

GRAYMAIL: CONSTITUTIONAL IMMUNITY FROM JUSTICE?

DAVID MENKHAUS*

Criminal defendants in cases involving national security information have successfully avoided prosecution in the past by threatening to disclose state secrets if they are put to trial. In 1980, Congress responded to this "graymail" phenomenon by enacting the Classified Information Procedures Act. In this Note, Mr. Menkhaus argues that, although the law should inhibit graymail, courts have always possessed the powers granted to them by the statute.

Introduction

"And ye shall know the truth, and the truth shall set you free."[1] Although St. John was speaking in an eschatological sense, his observation has an ironic truth to it when applied to a criminal defendant in a case involving national security information. Several recent cases have demonstrated that the more "truth" a criminal defendant knows about national security matters, the more likely it is that such a defendant will be set free without ever having gone to trial. The words of St. John pinpoint what has become known as the "graymail" problem: to protect the national security, the government must dismiss prosecutions against defendants who might reveal classified information in the course of a public trial. The source of this dilemma lies in a stark conflict of constitutional values: graymail pits a defendant's Sixth Amendment right to a public trial[2] against the government's need and duty to protect the national security.[3] The tension is further complicated by the

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1 *St. John* 9:32.

2 The Sixth Amendment provides: "In all criminal prosecutions, the accused shall enjoy the right to a speedy and public trial, by an impartial jury . . . ." U.S. CONST. amend. VI.

3 The executive's duty to protect the national security flows from his article II powers. This duty was recently recognized in United States v. Nixon, 418 U.S. 683, 706 (1974).

vague concept of the public's First Amendment right of access to trials.[4]

Recent graymail cases have involved politically charged issues and highly classified information, and as a result have generated a sizeable amount of public attention. This new awareness, combined with a trend towards increased congressional oversight of the intelligence community, led to hearings by the Subcommittee on Secrecy and Disclosure of the Senate Select Committee on Intelligence and by the Subcommittee on Legislation of the House Permanent Select Committee on Intelligence. These resulted in legislative proposals by the Senate,[5] the House,[6] and the Carter Administration.[7] The thrust of all three proposals was to create a procedural mechanism for restricting a defendant's access to national security information so as to avoid public disclosure during a trial. The end product of these proposals is the Classified Information Procedures Act, signed into law in October, 1980.[8]

The purpose of this Note is to explore the causes of the graymail phenomenon, to critique the Classified Information Procedures Act, and to suggest an alternative means of eliminating the immunity from justice enjoyed by defendants using the threat of graymail.

I. The Problem

The graymail problem can arise whenever a criminal defendant has the potential ability to introduce state secrets into evidence at a public trial.[9] This potential appears most obviously in the enforcement of the espionage laws,[10] where the objective

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4 *See* part II.B *infra*. The public's right of access has been implied from the First and Sixth Amendments.

5 S. 1482, 96th Cong., 1st Sess. (1979).

6 H.R. 4736, 96th Cong., 1st Sess. (1979).

7 H.R. 4745, 96th Cong., 1st Sess. (1979).

8 Pub. L. No. 96-456, 94 Stat. 2025 (1980).

9 Graymail exists in civil cases as well, including cases not involving the United States as a party; *e.g.*, litigation involving trade secrets where the owner of the secret would rather settle or default than reveal the secret. This Note will deal only with graymail in the context of criminal prosecutions, although many of the proposed solutions are equally applicable to civil litigation.

10 18 U.S.C. §§ 793, 794 (1976); 50 U.S.C. § 783 (1976). *See also* 18 U.S.C. § 641 (1976).

of the statutes to protect national security information clashes with the explicit purpose of the defendant to disseminate any such information he uncovers. Even where this criminal intent does not exist, such information is likely to be introduced as evidence in the course of a trial. The problem also appears, to a lesser extent, in attempts to apply certain criminal sanctions against present or former members of the intelligence community, who may threaten disclosures to avoid prosecution. Because a criminal defendant's right to a public trial is guaranteed by the Sixth Amendment, prosecution of an espionage case or of a case involving intelligence community personnel threatens to disseminate information the government seeks to protect. Thus, the question faced by prosecutors becomes: "To what extent are we willing to harm the national security in order to protect the national security?"[11]

The problem of exposing secrets in the course of a public trial arises from both the prosecution's burden of proof requirements and the discovery rights of the defendant. To convict a person under the existing espionage statutes,[12] the prosecution must prove not only that the information transferred relates to the national defense, but also that the defendant had reason to believe that the information could be used to injure the United States or to aid a foreign nation.[13] These substantive elements of the offense thus force the government to explain to the jury, and therefore to the public as well, the full significance of the information allegedly revealed by the defendant. If the recipient of the stolen information did not fully understand its significance initially, he and everyone else certainly will by the end of the trial. Further, the defendant's discovery rights entitle him to, *inter alia,* all materials "which are material to the preparation of his defense or are intended for use by the government as evidence in chief at the trial, or were obtained from or belong to the defendant";[14] any statements of a government witness

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11 *The Use of Classified Information in Litigation: Hearings Before the Subcomm. on Secrecy and Disclosure of the Senate Select Comm. on Intelligence,* 95th Cong., 2d Sess. 33 (1978) (statement of Deputy Assistant Attorney General Robert Keuch) [hereinafter cited as *Senate Hearings*].

12 18 U.S.C. §§ 793, 794 (1976).

13 *Id.*

14 FED. R. CRIM. P. 16(a)(1)(C).

relating to the subject matter of that witness' testimony;[15] and any information within the government's control that is favorable to the accused.[16] These discovery rights give a defendant the ability to further probe the operations of the intelligence agencies and their reams of classified information. Quite naturally, these agencies hesitate to lay bare their secrets to one being prosecuted for revealing them. This reluctance has generated conflicts between the Department of Justice and the intelligence community.[17]

Use of the graymail tactic has proved successful in a wide variety of cases. Reportedly, it has caused the dismissal of narcotics cases,[18] a possible murder case,[19] and a recent host of perjury-before-Congress cases.[20] Thus, the graymail problem does not exist simply as a hypothetical dilemma; it constitutes an ongoing, practical struggle of constitutional dimensions.

A. *The Judicial Problem*

Although the government's duty to protect the national security on the one hand and the defendant's Sixth Amendment right to a public trial, coupled with the public's First Amendment right of access to information on the other, appear to conflict, it is the premise of this Note that this apparent tension could have been eliminated by the judiciary even in the absence of new legislation. The judiciary's inflexible approach to potential conflicts was primarily responsible for inducing a legis-

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15 The Jencks Act, 18 U.S.C. § 3500 (1957). Such statements may be obtained by the defendant only after the government witness has testified. *Id.*

16 Brady v. Maryland, 373 U.S. 83 (1963).

17 *See generally* STAFF OF THE SUBCOMM. ON SECRECY AND DISCLOSURE OF THE SENATE SELECT COMM. ON INTELLIGENCE, 95TH CONG., 2D SESS., NATIONAL SECURITY SECRETS AND THE ADMINISTRATION OF JUSTICE 28-30 (Comm. Print 1978) [hereinafter cited as NATIONAL SECURITY SECRETS].

18 *Id.* at 13-14.

19 *Id.* at 14-15.

20 Former Director of Central Intelligence, Richard Helms was indicted for his false testimony before the Senate Foreign Affairs Committee in 1973. He and his attorney, Edward Bennett Williams, threatened to reveal whatever CIA operations they could if Helms were tried. The Department of Justice struck a deal with Helms in 1977, in which Helms would plead *nolo contendere* to a misdemeanor charge, and the Department would recommend that no jail sentence be given. Helms was fined $2000 and sentenced to one year's unsupervised probation. He still has full pension rights. Jenkins, *Graymail: The Justice Department's Bargain with the Devil*, 8 STUDENT LAW, 16 (Dec. 1979) [hereinafter cited as *Graymail*].

lative response to the graymail problem. Ironically, the new Classified Information Procedures Act merely directs the judiciary to exercise powers it has always possessed.

A primary reason for the persistence of the graymail problem is that prosecutors have been intimidated by threats of graymail. Such intimidation was possible for two reasons. First, a lack of cooperation from the intelligence community left prosecutors unsure of the strength of their cases; and second, the judiciary's unwillingness to fashion methods to protect classified information left prosecutors unsure whether the benefits of conviction outweighed the risks of disclosure.[21] The disclose-or-dismiss dilemma was thus thrust upon prosecutors at the outset of these classified information cases before they had sufficient information to assess the risks and benefits of seeking a conviction.

While some of the blame for the graymail problem can be attributed to organizational conflicts between the Department of Justice and the intelligence agencies and to the lack of accountability of prosecutors for the dismissal of prosecutions,[22] the courts have compounded the graymail problem by failing to treat cases involving classified information differently from other criminal cases. *United States v. Berrellez*,[23] a perjury-before-Congress case, is a perfect example. The defendant there advanced the affirmative defenses of jury nullification and inducement. He consequently sought discovery of highly classi-

21 HOUSE PERMANENT SELECT COMM. ON INTELLIGENCE, CLASSIFIED INFORMATION CRIMINAL TRIAL PROCEDURES ACT, H.R. REP. No. 831, 96th Cong., 2d Sess. 8-10 (1980). At least as late as 1978, it was the policy of the Department of Justice not to initiate espionage proceedings unless the intelligence community agreed to declassify all materials needed to make out the government's case. NATIONAL SECURITY SECRETS, *supra* note 17, at 7 n.16.

22 *Graymail, supra* note 20, suggests that graymail is most successful where the defendant is a high-ranking official, and draws the conclusion that that is the case because the Department of Justice is anxious to avoid highly political, potentially embarrassing cases. Query whether that conclusion necessarily follows, or whether perhaps the fact that the defendant is high-ranking means that he is able to reveal a much greater amount of classified information. *But see Senate Hearings, supra* note 11, at 117 (statement of Morton Halperin, Director, Center for National Security Studies) (suggesting that Department of Justice is unable to enforce the law against intelligence agency officials because of an inherent conflict of interests and, therefore, that a special prosecutor be appointed to handle these cases).

23 Crim. No. 78-00120 (D.D.C. 1978). *See also* H.R. REP. No. 831, *supra* note 21, at 9. On February 8, 1979, charges were dropped by the Justice Department to "avoid disclosure of information about American intelligence activity in Latin America." N.Y. Times, Feb. 9, 1979, § A, at 1, col. 3.

fied government documents as evidence to prove his allegations.[24] In response, the government sought a protective order[25] providing for an *in camera* showing by the government of the sensitive nature of the materials sought. The proposed order would have required the defendant and all witnesses to alert the court before disclosing any information covered by the order, at which time the court would have conducted an *in camera* hearing on the relevance of the information sought to be introduced.[26] The protective order was denied, the judge ruling that the question-by-question objection approach used in all other cases was the proper method in this case as well.[27]

The government petitioned the circuit court of appeals for a writ of mandamus directing the trial judge to issue the proposed protective order. In its petition, the government argued that since the protective order sought was, in effect, the equivalent of a motion *in limine*, there was ample precedent for the *in camera* procedure for determining relevance.[28] Side bars and motions *in limine* have long been accepted as means of avoiding mistrials by preventing the disclosure of highly prejudicial information in open court that a motion to strike would not cure.[29] In fact, the proposed protective order would seem less restrictive than a ruling on a motion *in limine*. In the latter, introduction of certain facts is forever barred from the outset, while in the former, the relevance ruling is withheld until the issue actually arises in the trial. Thus, use of a protective order creates far less danger from speculation about what facts might become relevant at some future point in the trial.

Further support for the government's protective order is given by sections (d) and (e) of Rule 16 of the Federal Rules of Criminal Procedure, which give the trial judge broad discre-

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24 H.R. REP. No. 831, *supra* note 21, at 9.

25 FED. R. CRIM. P. 16(d)(1).

26 Government's Petition for Mandamus, United States v. Berrellez, Crim. No. 78-00120 (D.D.C. 1978).

27 United States v. Berrellez, Crim. No. 78-00120 (D.D.C. 1978).

28 Government's Petition for Mandamus, *id.*

29 *Id. See* United States v. Williams, 545 F.2d 47, 50 (8th Cir. 1976) (excluding evidence claimed by defendant to be relevant to credibility); United States v. Red Feather, 392 F. Supp. 916 (D.S.D. 1975) (excluding defense evidence of passive cooperation of military with law enforcement officers at Wounded Knee); United States v. Nu-Phonics, Inc., 433 F. Supp. 1006 (E.D. Mich. 1977) (creating rebuttable presumption that some defense evidence is irrelevant in an antitrust conspiracy case).

tionary power to fashion discovery procedures to protect sensitive information.[30] Arguably, however, a discovery rule should not be read to provide the basis for *in camera* determinations of relevance to be made during the course of a trial. Nevertheless, authority for judicial control over classified information during the trial exists by implication and analogy.

In *United States v. Nixon,* [31] the Supreme Court, in rejecting President Nixon's claim of executive privilege, stated:

> When the privilege depends solely on the broad, undifferentiated claim of public interest in the confidentiality of such conversations, a confrontation with other values arises. Absent a claim of need to protect military, diplomatic, or sensitive national security secrets, we find it difficult to accept the argument that even the very important interest in confidentiality of Presidential communications is significantly diminished by production of such material for *in camera* inspection with all the protection that a district court will be obliged to provide.[32]

Thus, the Court clearly indicated the special importance of adequately protecting national security information and acknowledged a judicial duty to do so. It is also significant that the Court perceived a claim of national security to be more important than the President's claim for confidentiality, which was itself recognized to be of constitutional magnitude.[33]

In *United States v. Reynolds,*[34] the Court expressed its concern that all possible means be used to protect national security interests. It recognized that a claim of privilege for military secrets would prevail over even the most compelling necessity for discovery in a civil action.[35] Faced with the government's

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30 *See Advisory Committee's Notes on Amendments to the Federal Rules of Criminal Procedure,* 39 F.R.D. 69, 178 (1966) (note to Rule 16 (e)) (explicitly recognizing national security information as appropriate for protective order treatment).

31 418 U.S. 683 (1974).

32 *Id.* at 706. It should be noted that the claim made against Nixon, posed by a subpoena under FED. R. CRIM. P. 17, was later distinguished by a lower court as significantly more burdensome on the executive than claims for information made under the FED. R. CRIM. P. 16 discovery procedures which are at issue in graymail. United States v. Williams, 65 F.R.D. 422, 425 (1974).

33 "Whatever the nature of the privilege of confidentiality of Presidential communications in the exercise of Art. II powers, . . . the protection of the confidentiality of Presidential communications has [similar] constitutional underpinnings." 418 U.S. 683, 705-06 (1974).

34 345 U.S. 1 (1953).

35 *Id.* at 11.

refusal to submit classified reports to an *in camera* inspection by the trial judge, the Court said:

> It may be possible to satisfy the court, from all the circumstances of the case, that there is a reasonable danger that compulsion of the evidence will expose military matters which, in the interests of national security, should not be divulged. When this is the case, the occasion for the privilege is appropriate, and the court should not jeopardize the security which the privilege is meant to protect by insisting upon an examination of the evidence, even by the judge alone, in chambers.[36]

Thus, in a civil case, the interest in protecting national security information is so weighty that the Court would deny a party access to crucial information without ever even examining the information itself. Although a party's claim for discovery is more compelling in criminal cases, the precedent for giving special treatment to national security information is clearly established in both *Nixon* and *Reynolds*.

An analogous situation is provided by cases in which the government seeks to avoid disclosure of an informant's identity for fear of drying up sources of law enforcement information.[37] In such cases, disclosure is required only when the defendant's ability to obtain a fair trial might otherwise be impaired.[38]

Despite the apparent existence of authority for issuing the protective order sought by the government in *Berrellez*, the court of appeals denied the petition for a writ of mandamus, limiting its holding to the appropriateness of using an extraordinary writ in that case. Shortly thereafter, the prosecution of Mr. Berrellez was dropped,[39] and graymail had claimed another victim.

The graymail problem has been prolonged not only by the judiciary's refusal to handle national security cases differently from other criminal cases, but also by the government's per-

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36 *Id.* at 10.

37 *See, e.g.*, Roviaro v. United States, 353 U.S. 53 (1957); Scher v. United States, 305 U.S. 251 (1938); Will v. United States, 389 U.S. 90 (1967).

38 *See* United States v. Dedeyon, 584 F.2d 36 (1978) (holding that the district court "acted properly [in] restricting cross examination only where the information sought concerned national defense and had little, if any, relevance to the issues in this case").

39 *See* Wash. Post, Feb. 9, 1979, § A, at 1, col. 1; *see also* In re United States of America, No. 78-2158 (D.C. Cir., Jan. 26, 1979) *discussed in* H.R. REP. No. 831, *supra* note 21, at 9-10.

ception that the problem cannot be solved. In short, the government has treated the conflict between the duties to protect the national security and to accord the defendant a public trial as irreconcilable. By thus viewing the conflict, the government itself has largely created a mythical disclose-or-dismiss dilemma. Unfortunately, the government's perception of the problem has resulted in a kind of self-fulfilling prophecy.

The dilemma is the result of a misconception of the right to a public trial guaranteed to a criminal defendant by the Sixth Amendment. Neither the defendant's nor the public's right to a public trial has ever been thought to be absolute in contexts outside of graymail. Courts have long possessed and exercised the power to close parts of criminal trials. If the government had successfully sought to induce the court's exercise of this power in graymail cases, it is likely that no legislation like the Classified Information Procedures Act would ever have been necessary.

B. *Judicial Power to Close a Trial Versus Public's Right of Access to Trials*

Any attempt to evaluate the scope of the public's right to open trials must begin with the recent decision of the Supreme Court in *Richmond Newspapers, Inc. v. Virginia.*[40] The Court there held that the First Amendment implicitly guarantees the public the right to attend criminal trials.[41] The framing of the question presented, however, clearly limits the scope of the right recognized. The plurality opinion stated the issue as "whether a criminal trial itself may be closed to the public upon the unopposed request of a defendant, without any demonstration that closure is required to protect the defendant's superior right to a fair trial, or that some other overriding consideration requires closure."[42]

Although there was no majority opinion in *Richmond Newspapers*, six Justices either opined or concurred in opinions which stated that the public right of access to criminal trials

40 100 S. Ct. 2814 (1980).
41 *Id.* at 2829.
42 *Id.* at 2821.

recognized by the Court was not absolute. Chief Justice Burger, joined by Justices White and Stevens, wrote that:

> Absent an overriding interest articulated in findings, the trial of a criminal case must be open to the public. We have no occasion here to define the circumstances in which all or parts of a criminal trial may be closed to the public, . . . but our holding today does not mean that the First Amendment rights of the public and representatives of the press are absolute.[43]

In his separate concurrence, Justice Brennan, joined by Justice Marshall, pointed out that:

> any privilege of public access to governmental information is subject to a degree of restraint dictated by the nature of the information and countervailing interests in security and confidentiality.
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> . . . An assertion of the prerogative to gather information must accordingly be assayed by considering the information sought and the opposing interests invaded.
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> . . . What countervailing interests might be sufficiently compelling to reverse this presumption of openness need not concern us now. . . . For example, national security concerns about confidentiality may sometimes warrant closures during sensitive portions of trial proceedings, such as testimony about state secrets. . . .[44]

Justice Stewart also voiced his understanding that the public's First Amendment right of access was not absolute, although he focused on the courts' ability to limit access as a means of preserving the order and dignity of the courtroom rather than as a procedure for preserving state secrets.[45] Given the unambiguous position of the Court that the public's First Amendment right is not unqualified,[46] the question turns to whether the governmental interest in protecting national security information outweighs the public's right of access to criminal trials.[47]

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43 *Id.* at 2830 (footnote omitted).

44 *Id.* at 2833-39 (footnotes and citations omitted).

45 *Id.* at 2840.

46 Further, the Court's decision in Gannett Co. v. DePasquale, 443 U.S. 368 (1979), left little doubt that the public has no Sixth Amendment right to a public trial.

47 The second and more difficult question, addressed in part I.C *infra*, is whether

When the issue of limiting public access arises, there is a significant distinction between cases involving graymail and ordinary criminal cases. In the latter, it is the defendant, often joined by the government, who seeks closure. In that context, the public's right of access is pitted against the defendant's right to a fair trial, the defendant's express desire for a closed trial, and the state's consent to a closed trial. In a graymail situation, the positions of the parties are radically different from those in an ordinary criminal case. To effectuate the graymail ploy, the defendant must vigorously assert his right to a public trial. The defendant and the public assume complementary positions, leaving the government to assert its interest in obtaining convictions as against both the defendant's explicit and the public's implicit constitutional rights to an open trial. Thus, initially, a graymail case would appear to be the most compelling case for prohibiting closure of a criminal trial. Yet, analysis of the structural purposes of an open trial reveals that the intentions of these constitutional rights are in fact frustrated when the graymail ploy succeeds.

The virtues of a public trial, in addition to minimizing unfair treatment of defendants, have been recognized for more than 300 years.[48] These societal benefits were concisely stated in *Estes v. Texas*:[49]

> [the openness of the proceedings] arguably improves the quality of testimony, it may induce unknown witnesses to come forward with relevant testimony, it may move all trial participants to perform their duties conscientiously, and it gives the public the opportunity to observe the courts in the performance of their duties and to determine whether they are performing adequately.[50]

Thus, the primary benefit to the public from requiring open trials is that justice is more likely to be done when the judicial process is open to public scrutiny. The existence of graymail turns this proposition on its head: when successful, graymail

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this governmental interest is weighty enough to overcome the defendant's Sixth Amendment right to a public trial.

48 *See, e.g.*, M. HALE, HISTORY OF THE COMMON LAW OF ENGLAND 343 (Runnington ed. 1820) (written *circa* 1670), *cited in* Radin, *The Right to a Public Trial*, 6 TEMP. L.Q. 381, 382 (1932).

49 381 U.S. 532, 583 (1965) (Warren, C.J., concurring).

50 *Id.* (footnote omitted), *citing* 3 W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 372-73 (15th ed. 1809) *and* 6 WIGMORE, EVIDENCE 332-35 (3d ed. 1940).

eliminates any trial. Thus, in analyzing the public interest in a graymail case, the question becomes, "Is it better to have a partially secret trial than no trial at all?" If the definition of the public interest is that justice be done, the answer to that question is clear. Logically, if graymail results in the absence of a trial, the public will have no opportunity to judge the performance of the judicial system anyway, nor will there be any testimony given which might be enhanced or challenged. In fact, the absence of trials in successful graymail cases can create a lack of confidence in the integrity of the legal system, a sense that some underhanded, secret dealing is occurring.[51] Ironically, it is precisely this type of distrust that the public's right of access is designed to dispel. As stated by Chief Justice Burger in *Richmond Newspapers*:

> A result considered untoward may undermine public confidence, and where the trial has been concealed from public view an unexpected outcome can cause a reaction that the system at best has failed and at worst has been corrupted. To work effectively, it is important that society's criminal process "satisfy the appearance of justice" . . . .[52]

Obviously, the same rationale is applicable to graymail cases, in which the outcome of the case is secretly determined without a trial ever having been conducted.

Because the effect of graymail is to eliminate the potential for doing justice and to do so outside public scrutiny, it seems that the public interest lies in a compromise between the defendant's desire for openness and the government's desire for secrecy. In short, the public's interest is best served by a closure order narrowly limited to those portions of the trial which disclose information, the dissemination of which poses a threat to the national security. The closure order must be narrow enough to protect the values of a public trial, but sufficient to allow prosecution of the case. Such an order, designed to prevent disclosure of national secrets, should be considered to fall within the scope of permissible restraints on public access to trials. As stated by Justice Powell in *Gannett Co., Inc. v. DePasquale*:

> The right of access to courtroom proceedings, of course, is not absolute. It is limited both by the constitutional right

51 *See, e.g., Graymail, supra* note 20, at 16.
52 100 S. Ct. 2814, 2825 (1980) (citation omitted).

> of defendants to a fair trial, and by the needs of government to obtain just convictions and to preserve the confidentiality of sensitive information and the identity of informants.[53]

Further, in *United States v. Cianfrani*,[54] the Third Circuit asserted that closures limited to sensitive portions of a hearing were permissible when furthering a governmental interest in protecting the privacy of personal communications.[55] Adoption of such a least-restrictive-means approach was also suggested by the dissent in *Gannett*,[56] and was recently urged by the press in *Richmond Newspapers*.[57]

This approach serves to protect state secrets and fulfill the public's interest in law enforcement without seriously infringing on the values associated with the public's right of access to criminal trials. Thus, the right implicitly embodied in the First Amendment should not be viewed as an absolute bar to the use of well-tailored closure orders in graymail cases.[58]

C. *Judicial Power to Close a Trial versus Defendant's Right to a Public Trial*

The language of the Sixth Amendment expressly guarantees a criminal defendant the right to a public trial.[59] Any judicial resolution of the graymail dilemma requires some qualification of that right. Thus, the question raised is whether the governmental interest in obtaining convictions in cases dealing with national security information is strong enough to permit the infringement of an accused's right to a public trial. This Note

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53 443 U.S. 368, 398 (1979) (Powell, J., concurring) (citations omitted).

54 573 F.2d 835 (3d Cir. 1978).

55 *Id.* at 858-59.

56 443 U.S. 368, 433-46 (1979) (Blackmun, J., concurring in part and dissenting in part).

57 Brief for Appellant, at 62-65, 100 S. Ct. 2814 (1980). For further legal authority upholding limited closure orders, *see* discussion at part II.C *infra*. These authorities are not discussed here because they relate to the defendant's right to an open trial, not to the public's right.

58 *See generally* Note, *Trial Secrecy and the First Amendment Right of Public Access to Judicial Proceedings*, 91 HARV. L. REV. 1899 (1978) (positing that the governmental interest in obtaining convictions should take precedence over an unrestricted public right of access when such access would prevent convictions in a whole class of cases).

59 The Sixth Amendment provides that "in all criminal prosecutions the accused shall enjoy the right to a speedy and public trial . . . ." U.S. CONST. amend. VI.

concludes that, based on the historical development of the right and on legal precedent, the prosecutorial interest should prevail.

The defendant's right to a public trial has a curious history. The popular myth is that the right emerged from the abolition of the Star Chamber,[60] yet neither the English Petition of Right of 1621 nor the Bill of Rights of 1689 mentions the right to a public trial.[61] Indeed, even in Coke's *Commentary on Magna Charta*, which detailed the rights of Englishmen to due process, no mention of public trials is made.[62] Nonetheless, the assertion made in *In re Oliver*[63] that "[b]y immemorial usage, whenever the common law prevails, all trials are in open court, to which spectators are admitted," is certainly correct. As characterized by one commentator:

> What happened, then, was that a traditional feature of English trials, more or less accidental, was carried over into the American systems, and since it was relatively ancient, was treated with the reverence which so many other elements of the common law received, especially from lawyers of the community. I have called it accidental because it seems almost a necessary incident of jury trials, since the presence of a jury — involving a panel of thirty-six men and more — already insured the presence of a large part of the public. We need scarcely be reminded that the jury was the *patria*, the 'country' and that it was in that capacity and not as judges, that it was summoned.
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> . . . It certainly was not a deliberately planned safeguard against the dangers incident upon secrecy. But, however it arose, it has found formulation as a constitutional right in almost every state and in the United States Constitution. While the historical foundation created for it is purely mythical, the rationalization which the courts have attempted must be accepted. . . .[64]

In assessing the weight to be accorded to the accused's right to a public trial, the historical development of that right is significant. Unlike the rights to enjoy a fair and speedy trial by

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60 *See, e.g.*, Davis v. United States, 247 F. 394 (8th Cir. 1917).

61 Radin, *The Right to a Public Trial*, 6 TEMP. L.Q. 381 (1932).

62 *Id.* at 381-82.

63 333 U.S. 257, 266 (1948), *citing* 2 BISHOP, NEW CRIMINAL PROCEDURE § 957 (2d ed. 1913).

64 Radin, *supra* note 61, at 388-89. For a comprehensive list of states that have adopted the right to a public trial for the accused, *see* Note, *The Accused's Right to a Public Trial*, 42 NOTRE DAME LAW. 499, 500 n.11 (1967).

an impartial jury, to confront witnesses, to present evidence, and to obtain the assistance of counsel, the right to a public trial is not really aimed at any specific evil.[65] The significance of this historical fact is that so long as a constitutional presumption of openness exists, limited closures will not prevent a fair trial. In contrast, one could not propose that the accused be denied the assistance of counsel in an espionage case, or that the trial be postponed until the information was no longer sensitive, even though such proposals would reduce the graymail potential. In short, a general, conceptual harm to the system that cannot be translated into harm to the accused should not bar the careful use of closure orders in national security cases.

Legal precedents for judicial closure orders outside the graymail context are common. No doubt, part of the reason for the vast number of closures is the view, implicitly based on the historical development of the right to a public trial, that the defendant is not directly prejudiced by the exclusion of spectators.[66] Further support for ordering closures can be found in the constitutions of Alabama and Mississippi, and in the statutes of Massachusetts, Virginia, Georgia, and New York.[67] From these historical and legal bases have flowed ample authority to support the narrow closure orders proposed by this Note as a judicial means of eliminating the graymail dilemma.

There is presently only one case, however, which directly holds that a closure order, properly limited, is a constitutionally permissible means for preventing the disclosure of classified information. In *United States v. Grunden*,[68] the United States Court of Military Appeals held that, within carefully limited guidelines, the judge could exclude the public from a court-martial proceeding to protect the confidentiality of national security information. The court emphasized that it did not rely for its holding on the uniqueness of the military, despite recent Supreme Court cases acknowledging such uniqueness.[69] How-

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65 As noted by Radin, *supra* note 61, at 388, it is possible, but unlikely, that the right to public trial was a specific response to the French *Ancien Regime's lettre de cachet*.

66 *See, e.g.*, Reagan v. United States, 202 F. 488, 490 (9th Cir. 1913).

67 *See* Note, *The Right to a Public Trial in Criminal Cases*, 41 N.Y.U. L. Rev. 1138, 1146-47 (1966).

68 2 M.J. 116 (1977).

69 *Id.* at 121 n.9.

ever, it should be noted that the Manual for Courts-Martial does contain authority for a closure order to protect classified information.[70] The court, although it found the order in question to be too broad and therefore set aside the lower court's ruling, rested its conclusion that limited closures were constitutionally permissible on a recognized body of exceptions to the accused's right to a public trial. These traditional exceptions relate primarily to sex crimes and courtroom order, and have recently been broadened to include exclusions to protect airline hijacking profiles and the identity of undercover agents or informants.[71]

The hijacker profile cases referred to by the *Grunden* court are closely analogous to cases involving national security information. The hijacker profile is a secret set of criteria developed by the Federal Aviation Administration and the commercial airlines to identify potential skyjackers. Closure orders have been employed on the presumption that disclosure of the profile criteria would destroy the system's effectiveness. These closures, however, have been used only in pretrial suppression hearings.[72]

The first pretrial closure order in a hijacker profile case was issued in *United States v. Lopez.*[73] The hijacker profile dilemma was again resolved in favor of closure in *United States v. Bell.*[74] After acknowledging the significant governmental interest involved and the need for confidentiality, the Bell court dismissed the defendant's Sixth Amendment claim that his right to a public trial had been violated by simply noting that "there is precedent for the proposition that limited exceptions are constitutionally permissible."[75] The court's citation of *Sheppard v. Maxwell*, *Estes v. Texas*, and two lower court cases upholding less than total exclusion of the public[76] seems unconvincing. Nevertheless, the holding in *Bell* has been followed in principle in *United*

70 MANUAL FOR COURTS-MARTIAL ¶ 53e (1969).

71 *Grunden, supra* note 68, at 120-21 n.6.

72 *Cf.* Bennett v. Rundle, 419 F.2d 599 (2d Cir. 1969) (en banc) (holding that a pretrial suppression hearing is so much like a trial that the right to a public trial attaches to the pretrial suppression hearing as well).

73 328 F. Supp. 1077 (E.D.N.Y. 1971).

74 464 F.2d 667 (2d Cir.), *cert. denied*, 409 U.S. 991 (1972).

75 *Id.* at 670.

76 *Id.* Limiting the number of spectators and regulating their conduct to preserve order is a far cry from excluding everyone except counsel.

States v. Clark[77] and *United States v. Ruiz-Estrella*,[78] although in both instances the orders in question were set aside as overly broad.

The hijacker profile cases are sufficiently similar to national security cases that they leave little doubt that limited closure in the latter should be constitutionally permissible. Prior to *Lopez* and *Bell*, a hijacker profile case would have been a perfect target for the use of graymail. Like cases threatening the disclosure in open court of highly sensitive national security information, hijacker profile cases presented legitimate and weighty governmental interests which would be frustrated in the absence of a limited closure order. The fact that the partial closures occurred in pretrial suppression hearings, rather than during an actual trial, does not seem to distinguish sufficiently the two types of cases so as to require different results.[79]

Partial closures to protect proprietary information offer an additional, though somewhat weaker, analogy to the national security cases. In *Stamicarbon, N.V. v. American Cyanamid Co.*,[80] the Second Circuit recognized the power of a trial judge to restrict at least partially public access to a criminal contempt proceeding when testimoney would reveal valuable trade secrets. The court in that case affirmed the denial of injunctive relief because it thought the danger of disclosure was too remote. Nonetheless, it left no doubt that if disclosure of the trade secrets were likely, and if no less restrictive means could be employed to protect those secrets, then the defendant's right to a public trial would have to yield enough ground to accommodate limited exlusion of the public.[81] In reaching this conclusion, the court pointed out that there was no danger of the accused being abused by secret exercises of judicial power since all but small portions of the trial would be open to public scrutiny. Further, there was little or no possibility that an unknown witness with relevant information would come forward given

77 475 F.2d 240 (2d Cir. 1973).

78 481 F.2d 723 (2d Cir. 1973).

79 *See, e.g.*, Gannett Co., Inc. v. DePasquale, 443 U.S. 368, 433-37 (1979) (Blackmun, J., dissenting in part).

80 506 F.2d 532 (2d Cir. 1974).

81 *Id.* at 538-42.

the secret nature of the testimony that would be presented *in camera*.[82]

The protection of national security information clearly provides an even more compelling case for closure than does the protection of trade secrets. In *Stamicarbon*, there was no threat of harm to a significant governmental interest. Rather, the only danger was that a trade secret, valued at $1 million, might be revealed. This secret was owned by a third party (a foreign corporation at that) who had licensed its secret process to American Cyanamid, which was later charged by the government with criminal contempt for violation of an earlier antitrust consent decree. Thus, the government had nothing to gain from closing the trial.[83] Nonetheless, the court found that this private interest was sufficient to justify a limited infringement of the right to a public trial.

The governmental interest in protecting the identity of undercover agents has also been held sufficient to justify a limited closure order. In *Lloyd v. Vincent*,[84] the court recognized that the Sixth Amendment right to a public trial has never been thought to be absolute, and that its closure ruling was in accord with New York case law[85] in protecting the future usefulness and physical safety of undercover agents.[86] The concerns of future usefulness and physical safety which motivated the closure in *Vincent* also arise in a national security case posing a graymail threat. The governmental interest, although generally phrased as "protecting sources and techniques of intelligence gathering," is precisely the same.

Sex-crime cases have produced several exceptions to the defendant's right to a public trial. Indeed, those states allowing exclusion of the public by constitutional or statutory provision all make specific reference to sex crimes.[87] State courts historically have upheld exclusion of the public from trials involving sex-related crimes.[88] Because most of these cases were decided

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82 *Id.* at 541-42.

83 Nevertheless, the government did side with Stamicarbon, presumably in a desire to avoid irreparable injury to an innocent third party.

84 520 F.2d 1272 (2d Cir.), *cert. denied*, 423 U.S. 937 (1975).

85 *See* People v. Hinton, 31 N.Y.2d 71, 286 N.E.2d 265, 334 N.Y.S.2d 885 (1972), *cert. denied*, 410 U.S. 911 (1973).

86 520 F.2d at 1274-75.

87 *See* note 67 *supra*.

88 For a partial listing, *see* Radin, *supra* note 61, at 389 n.13 (citing in excess of 40 state cases upholding exclusion of the public from trials in sex-related cases). *See also* Globe Newspaper Co. v. Superior Court, 401 N.E.2d 360 (Sup. Jud. Ct. Mass. 1980).

before the Sixth Amendment was made applicable to the states, their existence is significant not as controlling precedent, but only to illustrate the fact that the right to a public trial, although firmly rooted in the common law, has not been viewed as essential to a fair trial. In the few federal cases confronting the issue of whether sex-crime trials could be closed, the courts have split.[89] The most definitive federal ruling on the constitutionality of exluding the public in a sex-related case is *United States v. Kobli*,[90] which held that a closure order excluding the general public, but not the press, the bar, or anyone the defendant specifically requested, violated the defendant's right to a public trial. No showing of prejudice was required. The court did concede, however, that the trial judge had the power to exclude specific classes of the public, such as minors or rowdy spectators.[91] The court also emphasized that in a trial of this nature, closure threatened a fair trial because an unknown witness with relevant information might come forward.

The sex-related cases in some respects present both stronger and weaker arguments for closure than do national security cases. On the one hand, the public interest in open proceedings in a sex-crime trial is not very compelling. Cases of that genre tend to attract primarily those seeking "a cheap thrill," whereas in a case raising national security issues, deep political concerns exist which are the subject of legitimate public interest and debate. Undoubtedly the public has a strong and legitimate interest in the enforcement of all of its criminal laws. Nevertheless, the prosecution of a sex case is far closer to a private dispute between the complaining witness and the accused than is the typical graymail situation. On the other hand, the defendant's interest in a public trial is far more compelling in a sex case than in the graymail case. The virtues cited by Chief Justice Warren in *Estes v. Texas*[92] are, in fact, fully applicable only to cases involving crimes against another person.[93]

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89 *Compare* Davis v. United States, 247 F. 394 (8th Cir. 1917) *with* Reagan v. United States, 202 F. 488 (9th Cir. 1913). *See also* Tanksley v. United States, 145 F.2d 58 (9th Cir. 1944); Callahan v. United States, 240 F. 683 (9th Cir. 1917); Geise v. United States, 265 F.2d 659 (9th Cir. 1959), *cert. denied*, 361 U.S. 842 (1959); Harris v. Stephens, 361 F.2d 888 (8th Cir. 1966), *cert. denied*, 386 U.S. 964 (1967).

90 172 F.2d 919 (3d Cir. 1949).

91 *Id.* at 922-94.

92 381 U.S. 532 (1965); *see* note 49 *supra* and accompanying text.

93 *Compare* United States v. Kobli, 172 F.2d 919 (3d Cir. 1949) *with* Stamicarbon, N.V. v. American Cyanamid Co., 506 F.2d 532 (2d Cir. 1974).

The final traditional class of cases qualifying the right to a public trial involve the orderly administration of justice. Commentators have unanimously recognized the power of a trial judge to maintain order in the court by excluding unruly spectators or by limiting attendance to the capacity of the courtroom.[94] *Sheppard v. Maxwell*[95] and *Estes v. Texas*[96] are both variants on this theme.

Two federal cases upholding partial exclusions of selected members of the public are of special significance in the analysis of the graymail problem. In *Orlando v. Fay*,[97] the record showed that the defendant was unruly throughout much of the trial, and that the prosecutor had informed the judge that several witnesses had been threatened by members of the audience known to be friends or relatives of the defendant. The trial judge excluded all members of the public except members of the press and members of the bar. The defendant claimed that this would prejudice his ability to find a rebuttal witness, but his objection was overruled. The Second Circuit upheld the exclusion order, holding that the trial was still public because the press and bar were allowed to remain. The court affirmed the clear authority of a trial judge to maintain order and to reject the defendant's claim of prejudice. In *Bruno v. Herold*,[98] the trial judge expelled all spectators except those seated in the second jury box on the ground that a group seated directly in front of the witness stand was intimidating the state's chief witness. Relying on *Orlando*, the court upheld the exclusion. The trial was not conducted *in camera*, and the defendant raised no claim of prejudice.

Analogous to the prosecution in a typical graymail case, the accused in a case presenting problems of courtroom behavior often has no control over the factors threatening the orderly prosecution of the case.[99] Graymail has survived because the

94 *See, e.g.*, Radin, note 61 *supra;* Note, *The Accused's Right to a Public Trial*, 42 NOTRE DAME LAW. 499 (1967); Note, *The Right to a Public Trial in Criminal Cases*, 41 N.Y.U. L. REV. 1138 (1966); Note, *Trial Secrecy and the First Amendment Right of Public Access to Judicial Proceedings*, 91 HARV. L. REV. 1899 (1978); Note, *The Accused's Right to a Public Trial*, 49 COLUM. L. REV. 110 (1949).

95 384 U.S. 333 (1966).

96 381 U.S. 532 (1965).

97 350 F.2d 967 (2d Cir. 1965), *cert. denied sub nom.* Orlando v. Follette, 384 U.S. 1008 (1966).

98 408 F.2d 125 (2d Cir. 1969), *cert. denied*, 397 U.S. 957 (1970).

99 *But cf.* Orlando v. Fay, 350 F.2d 967 (2d Cir. 1965) (emphasizing that defendant and his family were participating in and encouraging harassment of the witnesses).

courts have not applied the flexible standards used in these other situations. Had the courts also allowed problems such as courtroom order to go unchecked, graymail-like consequences would be the rule rather than the exception. Thus, the clear meaning of the hijacker profile cases, *Grunden*, the informant cases, *Stamicarbon*, the sex-crime cases, and the courtroom order cases is that the defendant's right to a public trial is not an absolute right, but a limited right that has historically given way to the governmental interest in obtaining convictions. There is no reason that this presumption should not be subordinated to the governmental interest in obtaining convictions in cases involving national security information. Of course, if there is ever a case in which the accused can show that his right to a fair trial would be prejudiced by a limited closure order, the defendant's right to a public trial, as well as to a fair trial, should prevail.[100] The failure of the government and the courts to adopt this analysis has necessitated congressional action in a sphere in which the judiciary is more knowledgeable and more flexible in its ability to respond to different situations.

II. The Congressional Response to the Problem

A. *Legislative History*

The Classified Information Procedures Act grew out of congressional consideration of three substantially similar bills: H.R. 4736 (the "House Bill"), H.R. 4745 (the "Administration Bill"), and S. 1482 (the "Senate Bill"). Each bill had at its core three basic requirements: (1) pretrial notice by the defendant of the intent to use classified information; (2) pretrial, *in camera* determination of the admissibility of classified information; and (3) interlocutory appeal by the government of any adverse ruling regarding the disclosure of classified information.[101] The House

100 An accused should be allowed to have family and close friends present in the courtroom. In such a case, the court should make such nondisclosure orders, enforceable by contempt sanctions, as are needed to protect the governmental interest. *Cf.* Stamicarbon, N.V. v. American Cyanamid Co., 506 F.2d 532 (2d Cir. 1974). If no such order would be effective, as in the case of an avowed spy whose family also posed a clear and present danger of disclosure, total exclusion would seem appropriate. *Cf.* Alderman v. United States, 394 U.S. 165, 197 (1969) (Harlan, J., dissenting).

101 *See* H.R. Rep. No. 831, *supra* note 21, pt. 1, at 10.

Bill and the Administration Bill were combined by the Subcommittee on Legislation of the House Permanent Select Committee on Intelligence and favorably reported to the whole committee as H.R. 4736. The legislation finally adopted by Congress and signed into law as the Classified Information Procedures Act is similar in most respects to the Senate Bill.

The most significant difference among the House Bill, the Administration Bill, and the Senate Bill was that only the House Bill did not cut back the scope of the Jencks Act.[102] This law makes a government witness' pretrial testimony available to the defendant, when it relates to the witness' trial testimony. Both the Administration Bill and the Senate Bill proposed an amendment to the Jencks Act which would deny a defendant the right to receive all or parts of statements containing classified information judicially determined to be consistent with a witness' testimony. Instead, the government would be permitted to excise or summarize the consistent parts of a statement containing classified information. Both bills in effect directed the courts to accept the government's claim of classification by prohibiting any challenge by the defendant to the propriety of classification.[103] Much to the contrary, the House Bill proposed to leave intact a defendant's right to discover all prior statements of a witness containing information relating to the subject matter of that witness' testimony.[104]

The proposed changes in the Jencks Act would have had the salutary effect of minimizing disclosures of national security information to the defendant, thereby reducing the risk of graymail. In order to accomplish this goal, however, the bills would have significantly encroached upon the defendant's ability to effectively cross-examine government witnesses. Although both bills would have mitigated this encroachment by requiring the trial judge to protect the defendant's right of confrontation and right to a fair trial, a trial judge could do so only by tacitly assuming the role of defense counsel.

The primary difficulty with this approach is that it seems to

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102 18 U.S.C. §§ 3500 *et seq.* (1976).

103 Although the bills speak of information found by the court to have been properly classified, realistically, few judges can be expected to ignore classification designations made by national security experts, especially without the benefit of input from a partly adverse to the government.

104 18 U.S.C. § 3500(e) (1976).

ignore the Supreme Court's holding in *Alderman v. United States.*[105] In that case the government sought to withhold certain surveillance records from the defendants because none of the information obtained from such records was even "arguably relevant."[106] The government conceded that some of the material contained no threat of injury to the public interest or national security, but argued it would be hard to distinguish that which threatened from that which did not.[107] Significantly, the government offered to have the trial judge determine the initial question of relevance in an *ex parte, in camera* setting. In rejecting this proposal, the Court stated:

> Although this may appear a modest proposal, especially since the standard for disclosure would be "arguable" relevance, we conclude that surveillance records as to which any petitioner has standing to object should be turned over to him without being screened *in camera* by the trial judge. Admittedly, there may be much learned from an electronic surveillance which ultimately contributes nothing to probative evidence. But winnowing this material from those items which might have made a substantial contribution to the case against a petitioner is a task which should not be entrusted wholly to the court in the first instance.[108]

The basis of the opinion was that defense counsel is far better equipped to determine relevance than is the judge. In effect, the *Alderman* decision created a mandatory rule of disclosure to the defendant[109] with exceptions limited to those already acknowledged by courts. The Court concluded that the governmental interest in preventing public disclosure of records can be satisfied by the issuance of protective orders.[110]

The dissents in *Alderman*[111] argued forcefully that cases involving national security information should be treated differently. Both emphasized that a defendant indicted for spying is more likely to ignore a court's nondisclosure ruling, and thereby

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105 394 U.S. 165 (1969). *Alderman* was decided together with two espionage cases, Ivanov v. United States and Butenko v. United States.

106 *Id.* at 181. The government conceded that if the information were relevant to the decision of the ultimate issue, it would be faced with a disclose-or-dismiss situation.

107 *Id.* at 181 n.13.

108 *Id.* at 182.

109 *Id.* at 182 n.14.

110 *Id.* at 184.

111 *Id.* at 197 (Harlan, J., dissenting), and 209 (Fortas, J., dissenting).

further damage national security by transmitting information, than is a normal defendant.[112] "Skepticism as to the court's ability to detect and turn over to the defendant all relevant material may be well founded, but *in camera* inspection does not so clearly threaten to deprive defendants of their constitutional rights that it justifies endangering the national security."[113] Nonetheless, the two espionage cases decided in conjunction with *Alderman* were treated by the majority in the same manner as was the surveillance case.

Although the Court in *Alderman* did not ground its holding in any constitutional language, it is at least arguable that the *ex parte* procedure rejected there, like the *ex parte* procedures proposed in the Administration Bill and the Senate Bill, violates the defendant's right to a fair trial by denying him the effective assistance of counsel.[114] Further, the strong language used by the Court in *Davis v. Alaska*,[115] in holding that a defendant's constitutional rights of confrontation can not be impaired even by a legitimate governmental interest in protecting juveniles, indicates that constitutional problems might have been created by the curtailment of Jencks Act rights proposed by the Administration Bill and the Senate Bill.

A second significant difference among the House Bill, Administration Bill, and Senate Bill concerned reciprocity of disclosures. The House Bill and Senate Bill provided that if the defendant were required to disclose classified information upon which he intended to rely, the government would then be required to disclose its rebuttal evidence, including rebuttal witnesses. The Administration Bill contained no reciprocity provision.

The difference in approach appears to stem from conflicting interpretations of *Wardius v. Oregon*.[116] The Court there held that Oregon's notice-of-alibi statute was fundamentally unfair and, therefore, in violation of the Fourteenth Amendment. Writing for a unamimous Court, Justice Marshall wrote that:

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112 *Id.*
113 *Id.* at 210 (Fortas, J., dissenting).
114 *Espionage Laws and Leaks: Hearings Before the Subcomm. on Legislation of the House Permanent Select Comm. on Intelligence*, 96th Cong., 1st Sess. 227-28 (1979) (statement of M. Tigor).
115 415 U.S. 308 (1974).
116 412 U.S. 470 (1973).

> We do not suggest that the Due Process Clause of its own force requires Oregon to adopt such [reciprocal] provisions. But we do hold that in the absence of a strong showing of state interests to the contrary, discovery must be a two-way street.[117]

Thus, the differences among the bills appear to reflect opposite conclusions as to whether there is a sufficiently strong state interest in not granting reciprocity. Notably, in the recently adopted rape-evidence legislation,[118] reciprocity is not required. One could therefore reasonably conclude that protection of national security information is a sufficiently compelling state interest to avoid any constitutional duty of reciprocity under *Wardius*.

A third area in which the three proposed bills differed involved the introduction and proof of contents of classified documents. Only the Administration Bill provided that portions of a classified document introduced into evidence could be summarized or excised to avoid unnecessary disclosure of classified information. Any summation or excision could have been permitted by the court only after the defendant was given an opportunity to object and to argue that the excluded portions were relevant to his defense.

The final significant difference among the three proposed bills was that both the House Bill and Senate Bill would have imposed unprecedented, detailed reporting requirements upon the Department of Justice. Both bills would have required the Department of Justice to report to the respective congressional intelligence oversight committees any decision not to prosecute because of a concern for national security. The report would further have had to explain in detail why prosecution would or could damage national security, and set forth the classified information involved as well as the probability of its disclosure had the defendant been prosecuted.

Not surprisingly, the Administration Bill contained no such detailed reporting requirements. The Department of Justice, as well as the American Bar Association, criticized the House and Senate proposals as unwarranted and dangerous incursions into

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117 *Id.* at 475 (citation omitted).
118 FED. R. CRIM. P. 412.

the traditional responsibilities of the executive branch.[119] Although Congress should be kept informed of the Justice Department's resolution of graymail problems, the proposed reporting requirements would certainly blur the lines of demarcation between the executive and legislative branches by giving Congress influence over prosecutorial decision-making.

B. *Legislative Analysis*

From the House, Administration, and Senate bills emerged the Classified Information Procedures Act (the "Act"). The Act is almost identical to the Senate bill.

The goal of the Act is to protect "classified information," defined in section 1(a) of the Act,[120] from unauthorized disclosure during the course of a criminal prosecution. Although it is a legislative attempt to minimize the number and effectiveness of graymail ploys, the Act does not purport to totally eliminate the graymail problem.

In general, the Act establishes pretrial procedures for courts to determine a defendant's access to and use of classified information in a trial. The underlying premise is that by imposing reasonable restraints, current uncertainties about the possibility of disclosure can be avoided, and the problem of graymail will effectively evaporate.

Section 2 of the Act provides for a pretrial conference upon the request of any party or the court in any case involving classified information. The purpose of the conference is to establish a schedule for implementing the notice requirements of section 5 and the hearing requirements of section 6. Under section 2, the pretrial conference is mandatory once requested, thereby adding a degree of certainty to pretrial practice not found in the Federal Rules of Criminal Procedure.[121]

Section 3 clarifies the court's authority to issue a protective

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119 *Graymail, S. 1482: Hearings Before the Subcomm. on Criminal Justice of the Senate Comm. on the Judiciary,* 96th Cong., 2d Sess. 70-71 (1980) (statement of ABA Comm. on Law and National Security).

120 Section 1 of the Act defines classified information as materials pertaining to national defense and foreign relations which have been classified by executive order, statute, or regulation. Thus, the Act is not designed to cover purely domestic intelligence information.

121 FED. R. CRIM. P. 17.1 makes the use of pretrial conferences discretionary.

order to prevent the disclosure of any classified information involved in the case. This section is intended to compel judges to issue protective orders under Rule 16 of the Federal Rules of Criminal Procedure.[122] The protective orders now mandated by section 3 could have been fashioned pursuant to this existing procedure, but inclusion of such a mandatory provision in the Act removes the uncertainties and inconsistencies of judicial responses to requests for protective orders.

Under the Senate Bill, the scope of the orders issued thereunder would have been limited to materials and information obtained by the defendant through the discovery process. Curiously, however, the language of section 3 was broadened from the original version of S. 1482[123] to extend beyond Rule 16 to any classified material acquired from the government in connection with the prosecution, whether obtained through discovery or not.

Section 4 of the Act authorizes the court, upon a sufficient showing, to permit the government to delete or summarize parts of documents that the defendant is entitled to receive. This provision raises an *Alderman* problem because it sanctions a nonadversarial, *in camera* proceeding which applies to any classified documents to be received by the defendant. This provision appears to conflict with *Alderman*'s holding that the trial judge cannot be used to screen material to determine relevance in an *ex parte, in camera* proceeding.[124] In fact, section 4 goes even beyond Justice Harlan's dissent in *Alderman* in the breadth of its application. Justices Harlan and Fortas both argued that a screening procedure was appropriate in the two espionage cases being considered with Alderman primarily because there was a high risk of continued disclosures by those defendants, even in the face of contempt sanctions.[125] In a prosecution not

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122 SENATE COMM. ON THE JUDICIARY, S. REP. No. 823, 96th Cong., 2d Sess. 6 (1980).

123 Section 3 of S. 1482 originally provided that:

> Upon request of the Government, the court shall issue a protective order to guard against the compromise of any classified information disclosed to the defendant.

Ideally, this language should have been qualified to clarify the intention that it cover only information disclosed to the defendant by the prosecution in connection with a prosecution.

124 394 U.S. 165, 182-84 & n.15 (1969).

125 *Id.* at 198-200 (Harlan, J., dissenting), and 210 (Fortas, J., dissenting).

involving espionage, Justice Harlan would not have permitted the *ex parte* screening of evidence by the judge, relying instead on the court's power to fashion protective orders with appropriate sanctions.[126] Section 4 makes no distinction between espionage cases and other cases in which classified information is involved, and authorizes an *ex parte* screening procedure for discovery materials in any case involving classified information. The Court in *Dennis v. United States*[127] describes the possible limits of this procedure:

> In our adversary system, it is enough for judges to judge. The determination of what may be useful to the defense can properly and effectively be made only by an advocate. The trial judge's function in this respect is limited to deciding whether a case has been made for production, and to supervise the process: for example, to cause the elimination of extraneous matter and to rule upon the applications by the Government for protective orders in unusual situations, such as those involving the Nation's security . . . .[128]

Section 4 may go beyond the bounds set by *Dennis*, as it requires a judge to determine the usefulness of information to the defendant, and weigh this against the government's need to keep such material secure.

Despite the unresolved difficulties, section 4 does not institute a novel procedure. Under Rule 16 (d)(1) of the Federal Rules of Criminal Procedure, the court, after an *ex parte, in camera* hearing, may authorize the government to withhold classified information from a defendant's discovery requests. The language of the rule itself permits the court to order that discovery be "denied, restricted or deferred, or [to] make such other order as is appropriate." Further, the comments of the Advisory

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126 *Id.* at 199-200 & n.9 (Harlan, J., dissenting).

127 384 U.S. 855 (1966) (compelling disclosure of grand jury minutes but permitting *in camera* deletion of "extraneous material").

128 *Id.* at 874-75 (footnote omitted). The Court's holding in Palermo v. United States, 360 U.S. 343 (1959) (interpreting Jencks Act, 18 U.S.C. § 3500(e) (1976)) is not to the contrary. There, the defendant sought production of a memorandum summarizing an IRS interrogation as a "statement" within the meaning of the Jencks Act. The defendant's argument that the nature of the memorandum should be determined in an adversarial proceeding was rejected out of hand because such a procedure would totally frustrate the purpose of 18 U.S.C. § 3500(e) (1976). That situation is quite different from the one section 4 seeks to cover. In *Palermo,* the judge was required to determine a question of law, one of statutory interpretation. A judge is presumed to be competent to make such a determination.

Committee with respect to Rule 16(d) clearly indicate that the authority now explicitly granted by section 4 was intended to have been granted by the existing Rule 16(d).[129]

Although the same result could have been achieved under existing law, passage of the Act may reduce the reluctance of courts to use this remedy. Nevertheless, the inclusion of section 4 is likely to invite controversy and protract the prosecution of national security cases. Under *Brady v. Maryland*,[130] the defendant is entitled to all favorable information held by the prosecution. Interpreting "favorable" to mean enabling the defendant to better prepare his case, one would expect that this right will be jeopardized each time the government seeks authorization from the court to summarize or delete information requested by the defendant.

The ultimate effect of expanded use of protective orders will be increasingly to place on trial judges the burden of representing the defendant, a responsibility consciously rejected by the Supreme Court in *Alderman*. Further, this burden will undoubtedly be extremely heavy. There were in 1973 at least 20 million classified documents in existence;[131] and overclassification of information is commonly acknowledged to be a widespread abuse.[132] The *ex parte, in camera* procedure authorized by section 4 will put the trial judge in the position of both rope and participant in a tug-of-war. The trial judge will not only have to assume the role of the absent defense counsel to assure that the defendant's *Brady* rights are not violated, but will also have to rely on the representations of the government that disclosure could injure the national security. The trial judge, taking the defendant's point of view, will have to remain skeptical about the need for classification;[133] however, the trial judge, not being an expert in national security matters, will be extremely

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129 *Advisory Committee Notes on Amendments to the Federal Rules of Criminal Procedure*, 39 F.R.D. 69, 178 (1966) (note to Rule 16 (e)). The Advisory Committee's comment specifically lists the protection of national security information as one possible consideration for issuing a protective order, and further states that the *ex parte, in camera* procedure is especially appropriate for protecting national security information from disclosure. *See also* S. REP. No. 823, 96th Cong., 2d Sess. 6 (1980).

130 373 U.S. 83 (1963).

131 Goodale, *Senate Bill No. 1 and the Freedom of Information Act: Do They Conflict?*, 28 ABA AD. L.J. 347, 349 (1976).

132 *See generally* NATIONAL SECURITY SECRETS, note 17 *supra*.

133 *See* notes 131 & 132 and accompanying text *supra*.

hesitant to tell the government that its national security experts who classified the information have read too many spy stories. Hence, one can expect that, despite the Act's good faith effort to ensure adequate representation of the defendant's interests, the government will be the only well represented party at the secret hearing, and deference to national security experts will dictate the outcome.

Protection of the defendant's rights is further reduced if a section 4 order is appealed after judgment is entered. In such a case, the court of appeals will be in a worse position than the trial court in trying to protect the defendant's *Brady* rights. Whereas the trial judge arguably is involved enough in the case to understand the significance of most information to the defense theories, the appellate judges will be faced with an isolated legal question to be resolved without the benefit of any factual input from the defendant. In an adversarial system of justice, any removal, even temporarily, of one of the adversaries is dangerous. Section 4 explicitly codifies the congressional intent to ignore this danger.

Section 5 forms half of the nucleus of the Act. It requires the defendant to give both the government and the court advance written notice if he has any reason to expect that he might cause the disclosure of classified information either prior to or during trial. Notice must be given within the time specified by the court, or, where no time has been specified, thirty days prior to trial. The notice must contain a general description of the classified information that might be disclosed.

If the defendant fails to comply, the court may preclude him from introducing or using any classified information not made the subject of the notification and prohibit the questioning of witnesses regarding such information. Both the notification procedure established in section 5(a) and the sanction established in section 5(b) have ample precedents in the Federal Rules of Criminal Procedure.[134]

The use of a notice requirement is a fair and logical method for pinpointing possible graymail problems early enough in the prosecution to allow the government to avert trouble. Further,

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134 *See* FED. R. CRIM. P. 12.1, 12.2.

the requirement that the notice contain a description of the classified information likely to be disclosed eliminates the defendant's chances of bluffing the prosecution into dismissing the case.

Section 6 forms the second half of the Act's nucleus. It provides that, upon the government's request, the trial court shall hold a hearing to determine the use, relevance, and admissibility of classified information, judgments which would otherwise be made at trial or during a normal pre-trial proceeding. Such a hearing is to be held *in camera* with both parties present, if the Attorney General certifies that an open proceeding would reveal classified information to the public. No explanation regarding the information's sensitivity is required, and the hearing may be held regardless of the actual likelihood of disclosure during trial. The government must notify the defendant of the hearing and must identify the classified information which will be at issue. If the information was not previously available to the defendant, the government may, with the court's approval, provide a generic description of the material.

The purpose of the hearing is to have the court determine, well in advance of trial, whether or how the classified information at issue may be used in pretrial and trial proceedings. The Act, notably, does not create special standards of relevance and admissibility for classified information. If the court rules that the information may not be used, the record is to be sealed, and the defendant may seek reconsideration either prior to or during trial. Where the court rules that the information may be used, the court may allow the government, after a new hearing, to summarize documents or substitute statements admitting the facts the classified information would tend to prove, as long as the defendant's right to a fair trial is not infringed. In connection with the foregoing, the government may submit an affidavit, explaining why disclosure would damage national security, which the court may examine *in camera* and *ex parte*. As an alternative to disclosure at trial, the court may order the government to stipulate to certain facts or make any other appropriate order, including dismissal. In the event of any ruling adverse to the government, the government is given the right to take an interlocutory appeal pursuant to section 7.

Section 6 establishes the protections sought by the government in *United States v. Berrellez:*[135] notice by the defendant before disclosure of classified information, followed by a hearing, *in camera,* to determine the relevance of such information. Section 6, however, goes one step further by authorizing the use of summaries and excised documents where the information is ruled to be relevant. Such a practice is sanctioned only where the trial judge determines that the defendant's fair trial rights are not prejudiced. *Alderman v. United States*[136] is not an obstacle to such a procedure, since section 6 envisions an adversary *in camera* hearing. The discretionary power to be used by the trial judge is closely analogous to that existing under rule 403 of the Federal Rules of Evidence.[137]

In practice, a defendant is likely to contend that his right to a fair trial will be prejudiced by redaction of documentary evidence because the possibility of redaction eliminates the leverage of graymail. As a result, one should expect that the trial judge's use of the discretion granted by section 6(c)(1)(B) will lead to an appeal[138] in virtually every case. However, increased appeals seem to be a reasonable price to pay for the flexibility offered by section 6. Indeed, that flexibility is essential to reducing the number of graymail situations confronting the government.

Section 6(f) adopts the reciprocity procedure proposed in H.R. 4736 and S. 1482. Thus, upon disclosure of the classified information the defendant intends or expects to rely upon, the government is required to provide the defendant with whatever sources it expects to use to rebut that information. Although not constitutionally required under *Wardius v. Oregon,*[139] section 6(f) is a proper attempt to treat the defendant fairly. In-

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135 Crim. No. 78-00120 (D.D.C. 1978). *See* note 23 *supra* and accompanying text.

136 394 U.S. 165, 182 (1969).

137 FED. R. EVID. 403 permits the court to exclude relevant evidence if "its probative value is substantially outweighed by the danger of unfair prejudice, confusion of the issues, or misleading the jury, or by considerations of undue delay, waste of time, or needless presentation of cumulative evidence."

138 Section 6(d) provides that information withheld by the court shall be sealed and preserved for appeal. This section also gives the defendant the opportunity to seek reconsideration by the trial judge. While section 7 allows the prosecution to make an interlocutory appeal of an order under section 6(c)(1), no such provision is made for the defendant.

139 412 U.S. 470 (1975). *See* notes 126 to 128 and accompanying text *supra.*

formation revealed by the government should not intensify the graymail problem as it is information the government will reveal at trial anyway. Therefore, the only effect of the reciprocity requirement will be to prevent the government from surprising the defendant at trial.

The most questionable aspect of section 6 appears to be its provision allowing the government to submit to the court a statement explaining the reason for classification. That provision contemplates that the submission and the court's review will be made *ex parte,* if so requested by the government. Because it does not require an adversarial hearing, this provision may conflict with *Alderman* by putting the court in the role of defense counsel. Arguably, such an uncontroverted statement, written or certified by national security experts, will influence the judge's ruling when it predicts gloom and doom in the event of disclosure.

On the other hand, one proponent of the *ex parte* submission and examination has argued that there is little chance of prejudice to the defendant because the trial judge would likely hear the government's arguments at the hearing itself, at which time the defendant could respond.[140] This position ignores the likelihood, however, that *ex parte* submission and review preclude the defendant from making informed counter-arguments. Further, permitting the government's major arguments to be made and assessed *ex parte* may turn the hearing into an empty formality. The only justification for section 6's *ex parte* provision is that requiring an explanation of the classification magnifies the graymail problem if the explanation is made known to the defendant. At least in cases where the defendant already has knowledge of the classified information, any increase in the possible leverage of a graymail ploy would probably be insignificant in the absence of an *ex parte* provision. In the absence of a showing by the government that the defendant is likely to disregard court orders prohibiting disclosure of classified information, as in a traditional espionage case, the government should not be permitted to make its arguments *ex parte,* and respect for the court's nondisclosure orders should be relied

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140 *Graymail Legislation: Hearings Before the Subcomm. on Legislation of the House Permanent Select Comm. on Intelligence,* 96th Cong., 1st Sess. 96 (1979) (statement of Philip A. Lacovara).

upon to protect both the defendant's right to a fair trial and the government's interest in the national security.

Section 7 of the Act provides for an interlocutory appeal by the government from any decision of the trial judge "authorizing the disclosure of classified information, imposing sanctions for nondisclosure of classified information, or refusing a protective order sought by the United States to prevent the disclosure of classified information." The court of appeals is required to give expedited treatment to any such interlocutory appeal. These provisions are clearly within the power of Congress and do not prejudice the rights of the defendant. More importantly, they alleviate the graymail problem by eliminating the "disclose or dismiss" dilemma the government would face upon an adverse ruling by the trial court. Section 7 thus seems eminently sensible and uncontroversial.

Section 8 of the Act in effect creates an exception to the requirements of the "best evidence" rule.[141] It permits the court to admit into evidence partial and excised writings and other materials. The provisions of section 8 are not inconsistent with the purpose of the "best evidence" rule, which is primarily to prevent the introduction of documentary evidence of questionable authenticity. Because the court, not the prosecution, has discretion over what parts of classified documents to admit into evidence, there seems to be no danger of prejudice to the defendant. Section 8 does achieve a graymail-minimizing effect by reducing the amount of classified information disclosed during trial.

Section 9 of the Act merely requires the Chief Justice of the United States to prescribe security procedures for the handling of classified information in the federal courts.

Section 10 requires the government, in cases where the prosecution must prove the defense-relatedness or classification status of material, to inform the defendant what portions of such material are being relied upon to establish that element of the crime. This provision simply requires the government to inform the defendant of the basis for its charges. In effect, section 10 is analogous to a mandatory requirement for a bill of particulars.[142] Such a requirement is appropriate, if not essential to a

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141 FED. R. EVID. art. X.

142 *Cf.* FED. R. CRIM. P. 7(f).

fair trial, since much of the information related to the charge may not be known to the defendant.

Section 11 provides that the Act may be amended as provided in section 2076, Title 28, United States Code.[143] This provision seems wise in that it enables the courts, which are directly involved in and effected by the act, to have input into the making of decisions which will enhance its effectiveness.

Sections 12 and 13 of the Act establish a reporting procedure to be followed by the Department of Justice in order to keep Congress informed as to the Act's effectiveness in resolving the graymail dilemma. The provisions of section 12 are quite controversial. These provisions require the Department of Justice to establish written guidelines for deciding whether or not to prosecute cases in which classified information might be revealed. Prosecutorial discretion is thus required to be justified in writing. Thereafter, the Attorney General is required under section 13 to report semi-annually to both the Permanent Select Committee on Intelligence of the United States House of Representatives and the Select Committee on Intelligence of the United States Senate on all national security cases not prosecuted because of the threat of disclosure. This report must include the information which might have been disclosed, as well as the probability and consequences of a disclosure.

The obvious difficulty with sections 12 and 13 is that they constitute an unprecedented encroachment of the legislative branch into the decision-making processes of the executive branch. Although the Act represents a significant improvement over the corresponding provisions of the House and Senate bills,[144] it still has the dangerous effect of giving Congress an opportunity to influence prosecutorial discretion. The ability of the federal courts to propose amendments to the Act,[145] combined with the Attorney General's duty to report annually on the general effectiveness of the Act,[146] gives Congress sufficient input regarding its lawmaking duties to obviate any need for the requirements established by sections 12 and 13.

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143 28 U.S.C. § 2076 (1976) empowers the Supreme Court to amend the Federal Rules of Evidence, subject to acquiescence by both houses of Congress.

144 *See* note 119 and accompanying text *supra*.

145 Section 11 of the act provides for amendment in accordance with the provisions of 28 U.S. § 2076 (1976).

146 Section 13 of the Act.

Significant by its absence from the Act is any provision amending the Jencks Act where classified information is involved. As previously discussed,[147] there were serious constitutional questions raised by the proposals in the Senate and Administration bills to cut back the scope of the Jencks Act, which gives a defendant the right to any statements of a government witness relating to the subject matter of that witness' testimony. Under the proposed bills, the defendant would have received only that information which the court determined, in an *ex parte, in camera* hearing, to be inconsistent with the witness' testimony. In addition to the constitutional questions surrounding the proposed amendment, there were also practical questions regarding the need for such an amendment in the first place. According to testimony on the subject,[148] there has been no graymail problem associated with the existing Jencks Act. Therefore, deletion of the proposed Jencks Act amendment from the Act was apparently a wise choice.

C. *Overall Critique of the Act*

1. Successes

The most valuable impact of the Act is that it will, in practice, minimize the opportunities for graymail by removing many of the prosecution's uncertainties associated with going to trial. No longer will a defendant be able to obtain a dismissal by threatening disclosure of information which, had the case actually gone to trial, might be found irrelevant or otherwise inadmissible. In short, by putting the classified information procedures into writing, Congress has eliminated much of the "gaming" aspect in this type of criminal litigation. The prosecution will now be guaranteed a set of procedures which, when applied, will allow the government to reasonably anticipate the nature and severity of disclosures of classified information which a defendant will be able to make in the course of exercising his constitutional rights to an open and fair trial.

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147 *See* text accompanying notes 102 to 104 *supra*.

148 H.R. Rep. No. 96-831, *supra* note 21, at 10; *Graymail, S. 1482: Hearings Before the Subcomm. on Criminal Justice of the Senate Comm. on the Judiciary*, 96th Cong., 2d Sess. 70 (1980) (statement of ABA Comm. on Law and Security).

Almost as importantly, the Act provides a clear statement to the courts that graymail is a serious problem, one which the courts must take an active role in solving. Many of the provisions of the Act restate in mandatory terms previously discretionary judicial functions. These provisions, directed to a very specific category of cases, highlight the fact that graymail represents a serious threat to the national security, a threat which the judiciary should combat by the use of all possible constitutional powers.

2. Failures

Overall, the Act makes few drastic changes in the law, but those it makes are of questionable wisdom. In large part, it simply codifies procedures and alternatives that were already available to, but infrequently used by, the courts and the prosecution. While the Act will diminish the magnitude of the graymail phenomenon, it will also diminish the already *de minimus* discovery rights of defendants in cases involving national security information.

Because it is limited solely to procedural solutions, the Act cannot possibly eliminate the graymail problem. Substantive changes in the espionage laws are essential to the resolution of the problem. Because graymail is both a substantive and a procedural phenomenon, the Act almost by definition can resolve only part of the problem.

The Act is also subject to criticism in that it creates a separate procedural mechanism for a very small class of cases. Although not inherently harmful, it creates a potentially harmful precedent. New, separate procedural legislation to deal with each type of sticky criminal case would clearly be unacceptable. The need for the act could have been obviated by very modest amendments to the existing Federal Rules of Criminal Procedure, the Federal Rules of Evidence and section 3731 of title 28, United States Code.

On a practical level, the Act was probably necessary because of the reluctance of the judiciary and prosecutors to approach the graymail problem with greater flexibility. Nevertheless, it should be given some theoretical scrutiny. In that light, the controlling consideration in enacting legislation to protect against

unnecessary disclosures of classified information in litigation should be the defendant's right to a fair trial. Rather than legislate right up to the line between that which is constitutionally permissible and that which is not, Congress should provide strong assurances to the defendant's right to a fair trial. Analyzed upon this premise, the Act at times pushes too close to this constitutional line.[149] It does so because of a theoretical misconception of the graymail problem. The Act seems to adopt the working premise that graymail can never be eliminated, and that the best that can be hoped for is to minimize the frequency of its occurrence; it seeks to cover almost every conceivable area in which graymail might arise and to legislate to the constitutional bounds in that area in order to remove graymail possibilities.[150]

The approach of the Act is paradoxical. It rests on the theory that the defendant's Sixth Amendment right to a public trial is absolute; therefore, in order to preserve that right of the defendant, it impinges on the defendant's discovery rights, rights essential to a fair trial. Thus, the Act represents a trade-off, required of the defendant, of valuable, practical, tactically useful rights in favor of a right that defendants in many cases seek to waive.[151]

As detailed earlier in this Note,[152] the Sixth Amendment's guarantee to a public trial, as well as the public's First Amendment right of access, are not, and have never been considered to be, absolute. Theoretically, the best procedural way to eliminate graymail problems would be to influence the judiciary to exercise its power to close those limited segments of a public trial in which classified information would be revealed. Such a system would preserve the defendant's right to the effective assistance of counsel without in any way increasing the potential for graymail.

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149 Specifically sections 4 and 6; *see* text accompanying notes 124 to 133 and 135 to 140 *supra*.

150 An exception is Congress' rejection of the Jencks Act amendments which were contained in the Senate Bill and the Administration Bill.

151 *See, e.g.*, Richmond Newspapers, Inc. v. Virginia, 100 S. Ct. 2814 (1980); Gannett Co., Inc. v. DePasquale, 43 N.Y.2d 370, 372 N.E.2d 544, 401 N.Y.S.2d 756 (1977), *aff'd*, 435 U.S. 368 (1979).

152 *See* parts I.B and I.C *supra*.

Conclusion

Although the Act is not the best theoretical solution to the graymail problem, and although it does not attempt to address substantive statutes that help to create potential graymail problems, in practice it will serve the purpose for which it was intended — it will help to eliminate what has heretofore been a form of constitutional immunity from justice.

NOTE

THE PROPOSED NATIONAL INITIATIVE AMENDMENT: A PARTICIPATORY PERSPECTIVE ON SUBSTANTIVE RESTRICTIONS AND PROCEDURAL REQUIREMENTS

JOHN R. SNYDER*

Despite increasing popularity of the initiative and referendum at the state and local levels, they are not yet authorized on the federal level by the United States Constitution. Legislation has been introduced in both houses of Congress proposing an amendment to the Constitution authorizing a national initiative.

In this Note, Mr. Snyder examines how the national initiative might operate. He analyzes policy objections to the initiative and possible legal grounds for limiting its scope. Finally, he argues that specific substantive restrictions and procedural safeguards could mitigate or eliminate most of the perceived problems with the national initiative.

Introduction

Increasingly in the last decade the citizens of various states and localities have been called upon to directly decide governmental issues of considerable import and consequence. Measures have been presented to voters for enactment or rejection on such topics as property taxes, rights of homosexuals, mandatory deposits on beverage containers, abortion, handgun control, nuclear power plant moratoria, and the site of the Winter Olympics.[1] This trend shows no signs of abating.[2]

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1 For a comprehensive list of state initiative measures from the turn of the century until 1976, *see Hearings Before the Subcomm. on the Constitution of the Comm. on the Judiciary, on S.J. Res. 67,* 95th Cong., 1st Sess. 355-80 (1977) [hereinafter cited as *Hearings*] ("A Compilation of Statewide Initiative Proposals Appearing on Ballots Through 1976").

2 *See generally Mass. Voters Cut Taxes as 42 States Decide Ballot Issues,* N.Y. Times, Nov. 6, 1980, § A, at 31, col. 1.

The constitutions of twenty-one states and the District of Columbia Code reserve to the people the power to propose legislation independently of the legislature and to enact such legislation (known as the power of initiative).[3] In addition, these states, as well as Maryland and New Mexico, reserve to the people the power to reject legislation enacted by the legislature (known as the referendum power).[4] In several more states the referendum power is available with regard to specified issues.[5] Finally, the powers of initiative and referendum are extended to the voters of municipalities or other localities in well over half the states, either by constitutional provision[6] or by statute.[7]

Despite the popularity of the initiative and referendum at the state and local levels, they are not yet authorized on the federal level by the United States Constitution. Legislation has been introduced in both houses of Congress proposing an amendment to the Constitution authorizing a national initiative.[8] As pro-

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3 ALAS. CONST. art. XI, §§ 1-7, ARIZ. CONST. art. IV, pt. I, §§ 1, 2; ARK. CONST. amend. VII, § 1 (supersedes art. V, § 1); CAL. CONST. art. II, §§ 8-12; COLO. CONST. art. V, § 1; D.C. Code §§ 1-181 to 1-187 (Supp. 1979); IDAHO CONST. art. III, § 1; ME. CONST. art. IV, pt. III, §§ 17-20; MASS. CONST. amend. XLVIII; MICH. CONST. art. II, § 9; MO. CONST. art. III, §§ 49-53; MONT. CONST. art. V, § 1, art. III, §§ 4-9; NEB. CONST. art. III, §§ 1-4; NEV. CONST. art. XIX, §§ 1-6; N.D. CONST. art. II, § 25 (amend. XXVI); OHIO CONST. art. II, §§ 1-1g; OKLA. CONST. art. V, §§ 1-8; OR. CONST. art. IV, § 1; S.D. CONST. art. III, § 1; UTAH CONST. art. VI, § 1(2); WASH. CONST. art. II, §§ 1, 1a, 41 (amends. 7, 26, 30, 36); WYO. CONST. art. III, § 52.

4 *See* note 3 *supra;* MD. CONST. art. XVI, §§ 1-6; N.M. CONST. art. IV, § 1. For compilative descriptions of state initiative and referendum procedures, *see Hearings, supra* note 1, at 280-352, 355-80 ("Initiative, Referendum and Recall: A Resumé of State Provisions"; "A Compilation of Statewide Initiative Proposals Appearing on Ballots Through 1976"); Note, *Initiative and Referendum—Do They Encourage or Impair Better State Government?,* 5 FLA. ST. U. L. REV. 925 (1977); Durant, A Comparison Among State Initiative Procedures (unpublished research paper available from Professor R. J. Allen, U. of Iowa College of Law, undated). *See also* L. TALLIAN, DIRECT DEMOCRACY, ch. X (1977).

5 *E.g.,* FLA. CONST. art. V, §§ 7(4) (qualifications for county judges), 9(1) (addition of criminal court judges), 11(1) (change of districts for justices-of-the-peace); KY. CONST. § 171 (law "classifying property and providing a lower rate of taxation on personal property, tangible or intangible, than upon real estate").

6 *E.g.,* ARIZ. CONST. art. IV, pt. I, § 1(8); ARK. CONST. amend. VII, § 1; CAL. CONST. art. II, § 11; COLO. CONST. art. V, § 1; FLA. CONST. art. VI, § 5; ILL. CONST. art. VII, § 11a; ME. CONST. art. IV, pt. III, § 21; MD. CONST. art. XVI, § 3(a) (referendum on local laws passed by state legislature); NEV. CONST. art. XIX, § 4; OHIO CONST. art. II, § 1f, art. X, § 1 (transfer of municipal power to county); OKLA. CONST. art. V, § 5; OR. CONST. art. IV, § 1(5), art. VI, § 10; S.D. CONST. art. III, § 1; UTAH CONST. art. VI, § 1(2); WYO. CONST. art. 13, § 1 (referendum).

7 *E.g.,* MISS. CODE ANN. §§ 21-9-65, 21-9-67 (referendum); N.Y. LAW (McKinney) MUN. HOME RULE §§ 23, 24 (mandatory referendum on enumerated items); WIS. STAT. § 9.20 (initiative).

8 S.J. Res. 67, 95th Cong., 1st Sess., 123 CONG. REC. 22189 (1977) (introduced by Sen. M. Hatfield and then-Sen. J. Abourezk); H.J. Res. 544, 95th Cong., 1st Sess.,

posed in Senate Joint Resolution 67,[9] the amendment declares that "the people . . . shall have the power to propose and enact laws. . . ."[10] This power is explicitly limited in two ways: (1) it does not extend to the enumerated Congressional powers in article I, section 8, clauses 11 (war powers) and 15 (suppression of insurrection);[11] and (2) it may not be used to enact any law "the enactment of which is forbidden the Congress by this Constitution or any amendment thereof."[12] Also, the initiative power explicitly does not extend to the proposal of constitutional amendments.[13] Initiated measures will be placed on the general election ballot if accompanied by a petition containing the signatures of registered voters equal in number to three percent of the ballots cast in the last general election for President.[14] These voters must be sufficiently geographically dispersed to include three percent of registered voters in each of ten states.[15] A proposed law would be enacted if approved "by a majority of the people casting votes with respect to such proposed law."[16] Any law so enacted could not be repealed or amended within two years of its effective date except by a two-thirds affirmative roll-call vote of both houses of Congress.[17]

This Note explores how the national initiative might operate, with particular reference to its scope, *i.e.*, the types of issues to which it would and would not apply. Policy objections to the

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123 CONG. REC. 22581 (1977) (introduced by Rep. G. VanderJagt); H.J. Res. 658, 95th Cong., 1st Sess., 123 CONG. REC. H12305 (daily ed. Nov. 8, 1977) (introduced by Rep. J. Jones).

9 The text of S.J. Res. 67 is set out in the Appendix.

10 S.J. Res. 67, § 1.

11 *Id.* § 1.

12 *Id.* § 3.

13 *Id.* § 1; *see generally* U.S. CONST. art. V.

14 S.J. Res. 67, § 2.

15 *Id.* § 2; *see generally* Moore v. Ogilvie, 394 U.S. 814 (1969) (state statute requiring nominating petitions of independent candidates for state office to have 25,000 voter signatures, including 200 voter signatures from each of 50 of the state's 102 counties, held an equal protection violation on the one person, one vote principle, where 49 counties contained over 93 percent of the state's registered voters).

16 S.J. Res. 67, § 3.

17 *Id.* § 3. For state provisions in this regard, *see* note 19 *infra*. No mention is made of any power of the people to amend or repeal during this period. Also note those states where the governor's veto power does not apply to laws enacted by the people. *E.g.*, ALAS. CONST. art. XI, § 6; ARIZ. CONST. art. IV, pt. I, § 1(6); ARK. CONST. amend. VII, § 1; MASS. CONST. amend. XLVIII, General Provisions, pt. V; MICH. CONST. art. II, § 9; MO. CONST. art. III, § 52(b); NEB. CONST. art. III, § 4; N.D. CONST. art. II, § 25; OHIO CONST. art. II, § 1b; OKLA. CONST. art. V., § 3; WASH. CONST. art. II, § 1(d) (amend. 7).

initiative as a means of legislating will be presented, and corresponding legal grounds (if any) for limiting the initiative's operation will be analyzed. Finally, specific substantive restrictions and procedural safeguards which might mitigate or eliminate the objections to the initiative proposal will be examined. While initiatives and referenda are conceptually distinct, similar issues arise with, and principles apply to, both of them. As a result, much of the discussion below is applicable to referenda as well as to initiatives.

Overview

General policy objections to the initiative as a means of legislating fall into three classes. First are the objections based on protection of cherished basic values or individual freedoms or rights. These objections may be said to be based on perceptions of likely electorate motives, unconscious prejudices, or parochialism. Second are the objections based on perceptions of limited electorate capacities, with respect to, *e.g.*, mental acuity, concern, time, or financial resources. Last are the objections based on institutional or structural grounds, *i.e.*, on the perceived need to permit compromised solutions to governmental problems and to assure efficient and consistent operation of government.

Legal grounds for limiting the initiative's operation in order to mitigate or eliminate the objections might be found in specific constitutional restrictions on congressional legislative power and in other constitutional principles as well. Further substantive restrictions or procedural safeguards could be explicitly provided in the amendment, or developed through judicial interpretation of the amendment's language and intent. The construction state courts have given state initiative provisions might provide some indication of the way federal courts would interpret similar provisions in the national initiative amendment.[18] Finally, additional protection against ill-advised initiatives would

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18 *See, e.g.,* Diamond Nat'l Corp. v. Lee, 333 F.2d 517, 525-26 (9th Cir. 1964) (where statute requiring construction is similar to that of another state, decisions construing statute in other state are persuasive); Barth v. White, 40 Ariz. 548, 551, 14 P.2d 743 (1932) (same holding with respect to the state constitutional provision and the state statute governing initiatives).

be afforded by giving Congress the power to amend or repeal such measures,[19] and by making the President's veto power applicable to initiatives approved by the people.[20] In this way the electorate's initiative power would be subject to some of the "checks and balances" that characterize the federal system.

The normative (as opposed to legal) argument to be made by advocates of direct participatory democracy is that the national initiative should not be subject to any explicit limitations, save perhaps those necessary to ensure its orderly utilization.[21] The idea that the initiative power should be unrestrained is rooted in the notion that the people are the ultimate and original source and depository of governmental (including legislative) power. This idea, implicit in the Preamble to the United States Constitution ("We, the People of the United States . . . do ordain and establish . . .") by itself, and extended to its logical limits, could be seen as implying that the people, acting in the aggregate, could take any governmental action they wished (assuming a legitimate decision-making apparatus).

Whether restrictions on the national initiative power are desirable in their own right or are the inevitable result of nego-

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19 *See, e.g.*, OKLA. CONST. art. V, § 7 (legislature not deprived of the right to repeal any law or propose or pass any measure); Granger v. City of Tulsa, 174 Okla. 565, 567, 51 P.2d 567 (1935) ("In those jurisdictions where the Constitution does not specifically prohibit the Legislature from repealing initiated legislation, . . . acts so passed are subject to repeal by the Legislature in the same manner as other ordinary legislative measures are repealed"). *But see, e.g.*, ALAS. CONST. art. XI, § 6 (no repeal within two years, but may be amended at any time); ARIZ. CONST. art. IV, pt. I, § 1(6) (no repeal or amendment); ARK. CONST. amend. VII, § 1 (only upon two-thirds vote); CALIF. CONST. art. 2, § 10(c) (only by a statute itself conditioned on approval by the electorate); D.C. Code § 1-184 (no re-adoption of rejected measure for one year); MICH. CONST. art. II, § 9 (initiated measures may be amended or repealed only by the people or three-fourths of the legislature; measures approved in a referendum may be freely amended); N.D. CONST. art. II, § 25 (only upon two-thirds vote); WASH. CONST. art. II. § 41 (amend. 26) (no amendment or repeal within two years except by two-thirds vote of legislature); WYO. CONST. art. III, § 52(f) (no repeal within two years, but may be amended at any time); Knez v. City of Seattle, 176 Wash. 283, 28 P.2d 1020 (1934) (initiative ordinance can be amended or repealed only by the voters, or by ordinance conditioned on voter approval). In the absence of controlling constitutional provision or legislation, some courts are loath to permit amendment or repeal; *In re Statham*, 45 Cal. App. 436, 439-40, 187 P. 986, 988 (1920) (ordinance dealing with same subject matter as referred ordinance permitted only if it essentially differs from the latter and enacted "not in bad faith and not with intent to evade the effect of the referendum"). *See generally* 33 A.L.R.2d 1118 (1954) (power of legislative body to amend, repeal, or abrogate initiative or referendum measure, or to enact measure defeated on referendum).

20 *See* note 17 *infra*.

21 The initiative is not subject to any explicit limitations in thirteen states. *See* Table 1 in Appendix.

tiation and compromise to obtain the amendment's ratification, it is likely that the final version of the amendment will contain some explicit restrictions. In determining what criteria should be used in selecting the explicit substantive exclusions or procedural safeguards to be included in the amendment the experience of the states with the initiative power could again be a useful guide.[22] The substantive restrictions included in state initiative provisions are set forth in Table I in the Appendix.[23] Any desired explicit exclusions should be precisely stated, as the federal courts could very well follow the state courts' lead in liberally construing constitutional initiative provisions.[24]

Regardless of the criteria for selection ultimately utilized, and despite theoretical objections to restrictions, proponents of the amendment should not overlook the value of exclusions and procedural safeguards as "bargaining chips" to induce ratification. R. G. Stewart noted the influence of compromise on the Massachusetts exclusions:

> Historically, these excluded matters were advanced at the Constitutional Convention by both proponents and opponents of the initiative-referendum. They represent a recognition by both that certain particularly sensitive or sophisticated areas of legislation should not be exposed to emotional electoral dialogue and impulsive enactment or rejection by the general public. They also represent a clear compromise

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22 *See generally* Justice Brandeis' oft-quoted statement on the value of states as testing grounds in New State Ice Co. v. Liebmann, 285 U.S. 262, 311 (1932) (dissenting opinion).

23 For a review of some of the restrictions on the state level, *see* Note, *Limitations on Initiative and Referendum,* 3 STAN. L. REV. 497 (1951); *see also* Fordham & Leach, *The Initiative and Referendum in Ohio,* 11 Ohio St. L.J. 495 (1950); Stewart, *Law of Initiative Referendum in Massachusetts,* 12 NEW ENG. L. REV. 455, 461 (1977); Trautman, *Initiative and Referendum in Washington — A Survey,* 49 WASH. L.REV. 55 (1973); Note, *Judicial Limitations on the Initiative and Referendum in California Municipalities,* 17 HAST. L.J. 805 (1966); Note, *Referendum — The Appropriations Exceptions in Nebraska,* 54 NEB. L. REV. 393 (1975); Comment, *The Scope of the Initiative and Referendum in California,* 54 CAL. L. REV. 1717 (1966).

24 *E.g.,* Thomas v. Bailey, 595 P.2d 1 (Alas. 1979); Municipality of Anchorage v. Frohne, 568 P.2d 3 (Alas. 1977); Boucher v. Engstrom, 528 P.2d 456 (Alas. 1974); Birkenfeld v. City of Berkeley, 17 Cal. 3d 129, 550 P.2d 1001, 130 Cal. Rptr. 465 (1976); Citizens Against a New Jail v. Board of Supervisors of Santa Cruz County, 63 Cal. App. 3d 559, 134 Cal. Rptr. 36 (1976); Opinion of the Justices, 275 A.2d 800 (Me. 1971); Keller v. Forney, 108 Ohio St. 463, 141 N.E. 16 (1923); *but see, e.g.,* cases requiring strict compliance with popular legislation provisions' conditions, City of Lawrence v. McArdle, 214 Kan. 862, 522 P.2d 420 (1974); Gittings v. Board of Supervisors of Elections, 38 Md. App. 674, 382 A.2d 349 (1978); Selinger v. Governor of Maryland, 266 Md. 431, 293 A.2d 817 (1972), *cert. den.,* 409 U.S. 1111 (1973).

> by the proponents of the initiative-referendum with the opponents whose primary theoretical argument was the inability of the general public to grapple with difficult legislative issues.[25]

The process of compromise through restriction of the initiative power noted above will reach a limit at the point where the cumulative effect of adopted restrictions is to eviscerate the initiative's role in government or its perceived availability to the public.[26] Restrictions short of that point would be equivalent to, or more severe than, those imposed on Congress.

Although the initiative amendment as proposed states that all constitutional restrictions on congressional power shall apply to the initiative power,[27] it could be argued that such a conclusion would be reached by the federal courts even in the absence of an explicit provision. The Supreme Court has held that the initiative power of state electorates is subject to constitutional limitation to the same extent as the legislative power of their representative assemblies.[28] This fact, together with the "incorporation" of the Bill of Rights protections into the Fourteenth Amendment, has led to the observation, with regard to the exclusions from the initiative power in Massachusetts, that:

> In the light of United States Supreme Court decisions . . . extending the Bill of Rights of the Federal Constitution

25 Stewart, *supra* note 23, at 461.

26 *Cf.* L. TALLIAN, note 4 *supra*.

27 S.J. Res. 67, § 3.

28 City of Eastlake v. Forest City Enterprises, Inc., 426 U.S. 668, 676 (1976) ("If the substantive result of the referendum is arbitrary and capricious, bearing no relation to the police power, then the fact that the voters of Eastlake wish it so would not save the restriction."); Hunter v. Erickson, 393 U.S. 385, 392 (1969) ("The sovereignty of the people is itself subject to those constitutional limitations which have been duly adopted and remain unrepealed."); Lucas v. 44th General Assembly of Colorado, 377 U.S. 713, 736-37 (1964) ("[T]he fact that an apportionment plan is adopted in a popular referendum is insufficient to sustain its constitutionality or to induce a court of equity to refuse to act. . . . A citizen's constitutional rights can hardly be infringed simply because a majority of the people choose that it [sic] be."); West Virginia State Bd. of Education v. Barnette, 319 U.S. 624, 638 (1943) ("One's . . . fundamental rights may not be submitted to vote; they depend on the outcome of no elections."); *see also* Seattle School Dist. No. 1 of King County, Washington v. State, 473 F. Supp. 996, 1011 (W.D. Wash. 1979) ("[T]he sovereignty of the people is subject to constitutional limitations just as are legislative enactments."); Hall v. St. Helena Parish School Bd., 197 F. Supp. 649, 659 (E.D. La. 1961), *aff'd*, 368 U.S. 515 (1962) ("No plebiscite can legalize an unjust discrimination."); Opinion of the Justices, 365 Mass. 648, 310 N.E.2d 348 (1974); Commonwealth v. Higgins, 277 Mass. 191, 193, 178 N.E. 536 (1931) (Initiatives "must bear the test of conformity to the Constitution to the same extent as must statutes enacted by the General Court.").

> fully to the states via interpretations of the Fourteenth Amendment, it would appear that the Initiative and Referendum Amendment initiative exclusions *re* religion, trial by jury, state aid to private sectarian institutions, compensation for property taken, unreasonable search, unreasonable bail, protections from martial law, freedom of the press, freedom of speech, freedom of assembly and freedom of elections are now wholly superfluous.[29]

The inherent-power-of-the-people argument is not dispositive of the explicit-limits issue, for while government under the Constitution exists as a means to exercise the inherent legislative power of the people, it also exists to protect and maintain individual freedom and rights. By mutual consent, the people have restricted their power to act in the aggregate to the extent necessary to avoid infringement of recognized freedoms and rights. With regard to federal legislative activity, the restrictions of primary significance are those contained in article I, section 9 (*e.g.*, no bills of attainder or *ex post facto* laws (clause 3)), and the Bill of Rights (*e.g.*, due process clause and equal protection principles implicit therein).[30] Also, the enumerated powers listed in article I, section 8, express limitations on legislative authority. These restrictions would be without value unless they applied to every action taken by the people in the aggregate, regardless of the degree of representative or popular support for a given course of governmental action or the decision-making method used. Measures adopted by a representative legislature and measures adopted through direct democracy are both equally capable of producing governmental action infringing the valued personal freedoms and rights. It follows that the constitutional restrictions on representative legislative power should apply equally to initiated legislation. In other words, the restrictions on legislative activity in the Constitution should be construed as restrictions on governmental action, not merely on congressional action *per se*.[31] Of course, these restrictions

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29 MASS. LEGISLATIVE RESEARCH COUNCIL, REPORT RELATIVE TO REVISING STATEWIDE INITIATIVE AND REFERENDUM PROVISIONS OF THE MASSACHUSETTS CONSTITUTION (H. 5435) 155 (1975).

30 *See* Buckley v. Valeo, 424 U.S. 1, 93 (1976) ("Equal protection analysis in the Fifth Amendment area is the same as that under the Fourteenth Amendment."); L. TRIBE, AMERICAN CONSTITUTIONAL LAW 992 (1978).

31 *Cf.* L. TRIBE, *supra* note 30, at 500 (Constitution's ban on bills of attainder "as barring trial by legislative method and not trial by legislative body").

are subject to alteration by mutual consent in the manner prescribed by article V of the Constitution.

The argument is made, however, that the initiative power is inherently so open to abuse that existing constitutional restrictions on legislative power would, in practice, be either ineffective or insufficient. In some instances the argument has been used to oppose the whole concept of initiative. In others, the argument has been asserted to justify restrictions on the initiative power going beyond those imposed on Congress by the Constitution.

In all events, a close examination of the perceived dangers inhering in the initiative power suggests that fears of abuse are somewhat exaggerated.

I. Objections to the Initiative Based on Protection of Individual Rights and Basic Values

Objections of this type are based on two primary concerns: the need to protect the rights of minorities and concern about the possible destructive effects of elections on important values and interests.

A. *Protection of Minorities against the "Tyranny of the Majority"*

The argument that oppression of minorities by the majority is more severe when the initiative is available than under a purely representative legislative scheme[32] has been most forcefully expressed in two articles on the dangers of direct democracy for racial minorities and the poor. Dean Derrick Bell, counselling a cautious approach to direct democracy, believes that

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32 That such overreaching is a potential problem in any majority-rule decision-making system was recognized by James Madison:

> Wherever the real power in Government lies, there is the danger of oppression. In our Government the real power lies in the majority of the Community, and the invasion of private rights is chiefly to be apprehended, not from the acts of Government contrary to the sense of its constituents, but from acts in which the Government is the mere instrument of the major number of the constituents.

5 Writings of James Madison 272 (Hunt ed. 1904), *quoted in* Reitman v. Mulkey, 387 U.S. 369, 387 (1967) (Douglas, J., concurring).

"direct legislation . . . today poses more danger to social progress than the problems of governmental unresponsiveness it was intended to cure."[33] Dean Bell asserts that the threat to minorities and the poor is greater under direct democracy than under representative democracy because of (1) the Supreme Court's refusal to examine discriminatory impact and to accord wealth suspect classification status in direct legislation cases,[34] and (2) the absence of the moderating influence of representative processes.[35] Bell buttresses his assertion with the contention that a significant portion of white voters are racially biased, and that voting on direct legislation reveals this bias.[36] He then downplays the desirability of direct popular participation in legislative decision-making *vis-a-vis* the traditional American value of protection of minority and individual interests.[37] Bell's remedies for the possibility of "irresponsible" referenda involve "heightened [judicial] scrutiny of ballot legislation . . . when [it] . . . carries potential harm to the rights of minority individuals,"[38] and prevention of dilution of the voting rights of minorities.[39]

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33 Bell, *The Referendum: Democracy's Barrier to Racial Equality*, 54 WASH. L. REV. 1, 17-18 (1978).

34 *Id.* at 2-9, analyzing James v. Valtierra, 402 U.S. 137 (1971) and City of Eastlake v. Forest City Enterprises, Inc., 426 U.S. 668 (1976), and concluding that "overt discrimination is rendered unnecessary by the adoption of standards facially neutral as to race and arguably legitimate in purpose, but which even the most unsophisticated voters recognize as effective in excluding poor and nonwhite groups." *Id.* at 9.

35 Bell, *supra* note 33, at 13-15:

> Public officials, even those elected on more or less overtly racist campaigns, may prove responsive to minority pressures for civil rights measures once in office or, at least, be open to the negotiation and give-and-take that constitutes much of the political process. . . . [D]irect democracy, carried out in the privacy of the voting booth, has diminished the ability of minority groups to participate in the democratic process. . . . [B]ecause it enables the voters' racial beliefs and fears to be recorded and tabulated in their pure form, the referendum has been a most effective facilitator of that bias, discrimination, and prejudice which has marred American democracy from its earliest day.

36 *Id.* at 9-13, 17-21 "[S]ocial attitudes toward racial equality are an appropriate litmus to measure the danger to blacks and other minorities which may result if those urging greater reliance on the referendum prevail. . . . The high priority many whites give to maintaining racial superiority will undoubtedly be expressed at the ballot box." *Id.* at 9-10, 13; *compare* Note, *Initiative and Referendum — Do They Encourage or Impair Better State Government?*, *supra* note 4, at 948 (after reviewing states' experience with direct legislation, concludes that "[t]he majority generally has not vented its prejudices through the direct legislation process . . . , and the courts have not hesitated to invalidate objectionable laws adopted through use of the initiative.").

37 Bell, *supra* note 33, at 15-17.

38 *Id.* at 23-24. No standard for such scrutiny is suggested.

39 *Id.* at 24-28. *See* the criticism of Professor Bell's analysis in Allen, *The National*

Professor James Seeley, after analyzing several cases involving repeal of open housing laws by popular vote, declares that

> the referendum differs from other legislative methods because it provides a procedure whereby legislative decisions can be made exclusively along the lines of racial prejudice. . . . [Unlike individual voters,] representatives must take a public position for which they are responsible. They must debate and discuss issues along somewhat rational lines if they hope to be re-elected by the public.[40]

Possible constitutional sources of restrictions enabling federal courts to prevent the majoritarian abuses of the initiative feared by Bell and Seeley are the due process clause of the Fifth Amendment and the equal protection principle implicit in that clause.[41]

It could be argued that the concept of procedural fairness inherent in due process (under the Fifth and Fourteenth Amendments) precludes any popular decision-making which might result in governmental action depriving individuals of life, liberty, or property, because it is presumed that whatever process is due (*e.g.*, notice and an opportunity to be heard) could not be provided as part of a popular election.[42] Although the usual line-

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Initiative Proposal: A Preliminary Analysis, 58 NEB. L. REV. 965, 1026-28 n.304 ("[T]he issue here is not racism but whether initiatives facilitate the expression of racial bias;" concluding that the evidence fails to support Bell's facilitation conclusion).

40 Seeley, *The Public Referendum and Minority Group Legislation: Postscript to Reitman v. Mulkey*, 55 CORNELL L. REV. 881, 902 (1970). On the dangers of direct democracy for racial minorities and the poor, *see, e.g.*, Wolfinger & Greenstein, *The Repeal of Fair Housing in California: An Analysis of Referendum Voting*, 62 AM. POL. SCI. REV. 753 (1968) (examination of voting behavior with regard to Proposition 14); Sager, *Insular Majorities Unabated: Warth v. Seldin and City of Eastlake v. Forest City Enterprises, Inc.*, 91 HARV. L. REV. 1373 (1978); Note, *Residential Zoning By Voter Participation: A Democratic Means to an Inequitable Result*, 46 U. CIN. L. REV. 539 (1977); Note, *The Application of the Equal Protection Clause to Referendum-Made Law: James v. Valtierra*, 1972 U. ILL. L.F. 408; Comment, *James v. Valtierra: Housing Discrimination by Referendum?*, 39 U. CHI. L. REV. 115 (1971). For a defense of direct democracy as producing results at least no worse for minorities than those produced by representative assemblies, *see* Allen, note 39 *supra*.

41 *See* note 30 *supra*.

42 *Cf.* Queen Creek Land & Cattle Corp. v. Yavapai County Bd. of Supervisors, 108 Ariz. 449, 501 P.2d 391 (1972) (referendum on zoning matter should not be enjoined, because process of notice and hearing is accomplished prior to the referendum and substantive judicial review is available after the election); West v. Portage, 392 Mich. 458, 476, 221 N.W.2d 303 (1974) (Williams, J., concurring) (referendum seeks only to retain the status quo after the procedural steps for change have been taken). It might also be argued that an indirect initiative process would provide an adequate hearing (*e.g.*, committee hearings, floor debate); *contra*, City of Fort Collins v. Dooney, 178 Colo. 25, 496 P.2d 316 (1972) (election campaign is an adequate substitute for the notice and hearing required by the due process clause).

drawing problems with regard to what constitutes such deprivation would be encountered, such an approach would create a protective barrier based on inherent procedural deficiencies of the initiative process, without creating a need to scrutinize the substantive fairness of a given proposal. Such preclusion has been mandated by some state courts without invocation of the due process clause on the basis of inconsistency with statutory procedural requirements (*e.g.*, the mandated procedure for enacting zoning ordinances).[43] Other state courts have invoked the due process clause, holding statutory procedural requirements to define what process is due.[44]

The due process clause, standing alone, could also be used to restrict use of the initiative power.[45] For example, the exclusion of administrative matters from the legislative arena is at least partially based on due process considerations.[46] When applications of governmental power become so specific as to be "administrative" in nature, procedural protections are actuated to ensure rational, disinterested, and consistent decisionmaking. Such specific applications are one of the kinds of governmental activity feared by those who believe the initiative is prone to majoritarian abuse. The administrative/legislative distinction thus represents an important restriction on the use of

43 *E.g.*, Sparta v. Spillane, 125 N.J. Super. 519, 312 A.2d 154 (1973) (zoning ordinance); Ex parte Farnsworth, 61 Tex. Crim. 353, 135 S.W. 538 (1911) (telephone rate regulation); Dewey v. Doxey-Layton Realty Co., 3 Utah 2d 1, 277 P.2d 805 (1954) (rezoning ordinance; initiative termed collateral attack on zoning statute); Dallas Ry. Co. v. Geller, 114 Tex. 484, 271 S.W. 1106 (1925); Southwestern Telegraph & Telephone Co. v. City of Dallas, 104 Tex. 114, 134 S.W. 321 (1911); *cf.* Arnett v. Kennedy, 416 U.S. 134, 153-54 (1974) (Rehnquist, J., plurality opinion) ("where the grant of a substantive right is inextricably intertwined with the limitations on the procedures which are to be employed in determining that right, a litigant . . . must take the bitter with the sweet"); *contra*, Associated Home Builders of Greater Eastbay, Inc., v. City of Livermore, 18 Cal. 3d 582, 135 Cal. Rptr. 41, 557 P.2d 473 (1976); *see also* 8A E. McQuillan, The Law of Municipal Corporations § 25.246, at 148 (Nichols, Smith, eds., 3d. ed. 1949).

44 *E.g.*, Forman v. Eagle Thrifty Drugs & Markets, 89 Nev. 378, 516 P.2d 1234 (1973) (zoning ordinance); City of Scottsdale v. Superior Court, 103 Ariz. 204, 439 P.2d 290 (1968) (zoning ordinance); State v. Donohue, 368 S.W.2d 432 (1963) (zoning ordinance).

45 *But cf.* Birkenfeld v. City of Berkeley, 17 Cal. 3d 129, 550 P.2d 1001, 130 Cal. Rptr. 465 (1976) (initiative enactment of local rent control measures not violate landlords' due process rights on the ground that tenants are in the majority).

46 *See, e.g.*, Bi-Metallic Co. v. State Bd. of Equalization, 239 U.S. 441, 445 (1915); *but cf.* San Diego Building Contractors Ass'n v. City Council, 13 Cal. 3d 205, 216, 529 P.2d 570, 118 Cal. Rptr. 146 (1974) ("when there is no . . . statutory requirement [of, *e.g.*, notice and hearing] the adoption of a general zoning law remains a legislative act, as to which due process does not require notice and hearing").

the initiative power from the perspective of minority groups.[47] In many instances where they would fear overreaching or oppression by the majority, the administrative/legislative distinction would insure effective recourse to a separate or specialized decision-making body. Indeed, amendment proponents might wish to concede an explicit exclusion of administrative matters, which might include a definition of "administrative" along the lines of those developed by the courts.[48]

The procedural fairness principle underlying the due process clause might also be advanced by procedural safeguards written into the initiative amendment. For example, an indirect initiative process might also provide an opportunity for the positions of minority groups to be heard. Under an indirect initiative procedure, proposed measures would have to be submitted to the legislature, and would only reach a popular vote if not enacted by the legislature in substantially the same form as submitted within a specified time period.[49] Such a procedure could be set up to allow minority viewpoints to be heard in committee hearings on proposed measures, or in floor debate on such measures. Other procedural safeguards that might be instituted to ensure that minority viewpoints are heard and considered include a mandatory pre-election "debate period" (a period between certification of a measure for the ballot and the election long enough to allow all sides of an issue to be aired),[50] provision for regulation of initiative campaign finances, public funding of initiative campaigns,[51] and equal media access.[52]

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47 *See* Bell, *supra* note 33, at 8 n.38 (discussing use of referenda to block low-income housing projects).

48 *See* further discussion of the administrative/legislative distinction at note 132 *infra*.

49 *See, e.g.,* ALAS. CONST. art. XI, § 4; ME. CONST. art. IV, pt. III, § 18; MASS. CONST. amend. XLVIII, Initiative, pts. III and V; MICH. CONST. art. II, § 9; NEV. CONST. art. XIX, § 2(3); OHIO CONST. art. II, § 1b; WASH. CONST. art. II, § 1(a); WYO. CONST. art. III, § 52(d).

50 This "debate period" would be at least 120 days under the S.J. Res. 67 proposal. Most state constitutions' initiative provisions set filing deadlines, ranging from ten days (Ohio, Utah, and Washington) to four months (Arizona, Arkansas, Colorado, Idaho, Missouri, Nebraska, and Oregon) before the election. *See* Note, *Initiative and Referendum — Do They Encourage or Impair Better State Government?, supra* note 4, at 928-29.

51 *Cf.* Federal Election Campaign Act of 1971, as amended, 2 U.S.C. §§ 431-455 (1977 and 1980 supp.), *reviewed in* Buckley v. Valeo, 424 U.S. 1 (1976) (invalidating the act's expenditure limitations, but upholding, *inter alia,* its subsidies to candidates).

52 *Cf.* Red Lion Broadcasting Co. v. Federal Communications Comm'n, 395 U.S. 367 (1969) (upholding the FCC "fairness doctrine" and regulations thereunder, now, as amended, at 47 C.F.R. §§ 73.1910, 73.1920, 73.1930, & 73.1940 (1979)); *see generally*

The equal protection principle focuses not on procedural considerations, such as the opportunity to be heard, but on the even-handedness of governmental action. "Neither in theory nor in operation . . . can a norm of equality be given real content without imposing significant constraints upon the substantive choices that political majorities . . . might feel strongly inclined to make."[53]

There are two important touchstones of equal protection analysis as applied to the initiative power: motive and invidious classification. The motive inquiry is expressed in the requirement in *James v. Valtierra* that, in order to establish an equal protection violation, "a law seemingly neutral on its face" must be "in fact aimed at a racial minority."[54] This prerequisite, as Dean Bell notes, has constituted a considerable barrier for equal protection challenges of initiated measures by minority groups in the past.[55] The burden has been exacerbated by the reluctance of most courts to examine electorate motives.[56] This reluctance has perhaps been based on a notion that the motives of voters in the aggregate must be presumed to be of the highest order.[57]

Columbia Broadcasting System, Inc. v. Democratic Nat'l Comm., 412 U.S. 94 (1973) (no constitutional requirement that the electronic media sell time for unedited discussion of public issues); Miami Herald Publishing Co. v. Tornillo, 418 U.S. 241 (1974) (Florida statute compelling newspapers to publish the replies of political candidates whom they had attacked invalidated); *see also* 47 U.S.C. § 315 (1972) (equal opportunities for candidates for public office; public issues discussion opportunities).

53 L. TRIBE, *supra* note 30, at 991.

54 402 U.S. 137, 141 (1971), *citing* Gomillon v. Lightfoot, 364 U.S. 339 (1960).

55 Bell, *supra* note 33, at 2-9; *see also* Note, *The Application of the Equal Protection Clause to Referendum-Made Law; James v. Valtierra*, *supra* note 40, at 426:

> The Supreme Court has not examined the constitutionality of individual referendums which may be motivated by racial prejudice. Hence, the use of referendums to defeat low cost housing projects can still be challenged by attacking the racial motive behind the referendum vote. *Valtierra* suggests, however, that the Court will not accept arguments that a referendum is unconstitutional solely becuase its effect is to disadvantage blacks unless a specific motive to do so is shown.

56 *See* Southern Alameda Spanish Speaking Organization v. City of Union City, 424 F.2d 291 (9th Cir. 1970); Ranjel v. Lansing, 417 F.2d 321 (6th Cir. 1969); Kahalekai v. Doi, 60 Haw. 318, 590 P.2d 543, 551 (1979) (constitutional amendments); Carpenter v. State, 179 Neb. 628, 139 N.W.2d 541, 545 (1966) (same); *contra*, Otey v. Common Council of the City of Milwaukee, 281 F. Supp. 264 (E.D. Wis. 1968) (expert testimony on voter attitudes and motivation heard); *cf.* Reitman v. Mulkey, 387 U.S. 369 (1967); *see* Bell, *supra* note 33, at 2-9; Note, *The Application of the Equal Protection Clause to Referendum-Made Law: James v. Valtierra*, *supra* note 40, at 426.

57 "Provisions for referendums demonstrate devotion to democracy, not to bias, discrimination, or prejudice." James v. Valtierra, 402 U.S. 137, 141 (1971); *see also* Note, *The Application of the Equal Protection Clause to Referendum-Made Law: James v. Valtierra*, *supra* note 40, at 427; *cf.* L. TRIBE, *supra* note 30, at 485 n.14 ("[A]

Indeed, nonracial motives have sometimes been readily attributed to the electorate by the courts.[58]

However, recent signs indicate that this reluctance to examine electorate motives may be abating. For example, in *Seattle School District No. 1 of King County, Washington v. State,*[59] an initiative forbidding mandatory assignment of students for racial purposes was held an unconstitutional denial of equal protection on the grounds, *inter alia,* that a "racially discriminatory intent or purpose was one of the factors which motivated the adoption of the initiative."[60] Judge Voorhees declared that

> [t]he fact that it is impossible to determine whether there was subjectively a racially discriminatory intent or purpose does not . . . relieve this court of the burden of determining whether there was in fact such an intent or purpose behind the adoption of Initiative 350. One must simply look elsewhere than within the minds of the voters.[61]

The *Seattle School* court proceeded to examine the factors considered by the Supreme Court in *Village of Arlington Heights v. Metropolitan Housing Development Corp.*[62] and again applied by that Court in *Personnel Administrator of Massachusetts v. Feeney.*[63] The *Seattle School* court concluded that

> [t]he racially disproportionate impact of the initiative when coupled with its historical background, the sequence of events leading to its adoption and the departure from the procedural norm demonstrate that a racially discriminatory intent or purpose was at least one motivating factor in the adoption of the initiative.[64]

Professor Seeley, obviously rejecting any presumption of legitimate electorate motives, offers two standards for extension of the equal protection principle to prevent majoritarian abuse of the initiative power.[65] First, based on the principle that "[t]he

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constitutional amendment adopted by popular referendum does not pose quite the same threats of overly centralized governmental power and disguised motives which legislation entails.").

58 *E.g.*, James v. Valtierra, 402 U.S. 137, 143 (1971).

59 473 F. Supp. 966 (W.D. Wash. 1979).

60 *Id.* at 1011.

61 *Id.* at 1014.

62 429 U.S. 252 (1977).

63 442 U.S. 256 (1979); *see also* Washington v. Davis, 426 U.S. 229 (1976).

64 473 F. Supp. 966, 1016 (W.D. Wash. 1979).

65 Seeley, *supra* note 40, at 902-04.

state cannot promote a system that facilitates the operation of private racial discrimination,"[66] he suggests that

> when the law being considered is one that is susceptible to racial bias, and the social milieu is such that it is highly predictable that referendum voting will be on the basis of race, . . . the procedure [should] be said to violate equal protection as a state-provided vehicle for discrimination.[67]

Second, he argues that if access to the legislative process were considered a fundamental right to which all were entitled even if special treatment were necessary to ensure such access,[68] "legislation protecting racial minorities should not be submitted for ratification to a body likely to respond solely on the basis of irrational prejudice," but rather to a representative assembly.[69]

Under the second touchstone of equal protection analysis "no discrete and insular minority" or "independently identifiable group or category" can be singled out for special treatment unless such classification has a rational basis, or, if a fundamental right is involved, unless it can withstand the court's "strict scrutiny."[70] To constitute an equal protection violation, such "singling out" must be an integral, inevitable part of the legislation. Courts will not ordinarily inquire as to discriminatory effects or impacts,[71] despite the fact that "the existence of a single discrete issue" in direct legislation "makes it far easier [than with representative legislation] 'to determine whether

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66 *Id.* at 902, *citing* Anderson v. Martin, 375 U.S. 399 (1964); Nixon v. Condon, 286 U.S. 73 (1932); and Shelley v. Kraemer, 334 U.S. 1 (1948).

67 *Id.* at 903.

68 *Id.* at 903, *citing* Griffin v. Illinois, 351 U.S. 12 (1956) *and* Douglas v. California, 372 U.S. 353 (1963).

69 *Id.* at 903.

70 Gordon v. Lance, 403 U.S. 1, 5, 7 (1971): *cf.* Hunter v. Erickson, 393 U.S. 385 (1969); Reitman v. Mulkey, 387 U.S. 369 (1967); James v. Valtierra, 402 U.S. 137 (1971).

71 *See* Note, *Residential Zoning by Voter Participation: A Democratic Means to an Inequitable Result, supra* note 40, at 552. "The Court has made a value judgment that a democratic process is more important than the result it achieves." *Id.* (comparing Emporium Capwell Co. v. Western Addition Community Organization, 420 U.S. 50 (1975) (interpreted to hold that the value of the collective bargaining process is higher than the national policy against racial discrimination)); *cf.* Note, *The Application of the Equal Protection Clause to Referendum-Made Law: James v. Valtierra, supra* note 40, at 421 (given the undesirability and unworkability of judicial inquiries into electorate motive, "it would seem desirable to judge the constitutionality of a law solely by its effects").

its adoption or rejection will have a disproportionate impact on an identifiable group of voters.'"[72]

Given that the equal protection principle has provided inadequate protection for minorities against majoritarian overreaching in the past, the amendment drafters should perhaps consider procedural safeguards which would reduce the danger of such overreaching. These could include a requirement that initiated measures be approved by more than a simple majority, or by a majority in a majority of states.[73] It might be said that

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72 L. TRIBE, *supra* note 30, at 772, *quoting* Town of Lockport v. Citizens for Community Action at the Local Level, Inc., 430 U.S. 259, 266 (1977).

73 *See* Allen, *The National Initiative Proposal: A Preliminary Analysis*, 58 NEB. L. REV. 965, 1043-46 (1979). As to supermajority requirements, *see* Gordon v. Lance, 403 U.S. 1 (1971) (state requirement of a three-fifths vote in referenda on bond issues or tax rate increases upheld against equal protection challenge); Lacy & Martin, *The Extraordinary Majority: The Supreme Court's Retreat From Voting Equity*, 10 CALIF. W. L. REV. 551 (1974); McLaughlin, *What Has the Supreme Court Taught?*, 72 W. VA. L. REV. 1 (1970); 11 B.C. IND. & COM. L. REV. 553 (1970); Comment, *Extraordinary Majority Requirements and the Equal Protection Clause*, 70 COLUM. L. REV .486 (1970); Comment, *Extraordinary Majority Voting Standards*, 58 GEO. L.J. 411 (1969); Note, 83 HARV. L. REV. 1911 (1970); Comment, *Judicial Activism and Municipal Bonds: Killing Two-Thirds With One Stone?*, 56 VA. L. REV. 297 (1970). As to a "dispersed" majority requirement, *see* Town of Lockport v. Citizens for Community Action at the Local Level, Inc., 430 U.S. 259 (1977) (upholding against equal protection challenge a provision of the New York constitution under which a county charter can be adopted only if approved by a majority of the city dwellers voting in the county and by a majority of the voting non-city dwellers). For a discussion of the "minority legislation" issue (*i.e.*, a majority of those voting on the proposal, but a minority of all those casting votes in the election as a whole) engendered by similar standards in state constitutions, *see* LaPalombara & Hagan, *Direct Legislation: An Appraisal and a Suggestion*, 45 AM. POL. SCI. REV. 400, 417-19 (1951); Note, *Initiative and Referendum — Do They Encourage or Impair Better State Government?*, *supra* note 4, at 941, 947.

Notwithstanding this problem, most initiative and referendum states continue to use the same standard. *See, e.g.*, MD. CONST. art. XVI, § 5(b) ("majority of the votes cast on any such measure"); MICH. CONST. art. II, § 9 ("a majority of the votes cast thereon"); MO. CONST. art. III, § 51 (same); NEB. CONST. art. III, § 4 ("a majority of the votes cast thereon, and not less than thirty-five per cent of the total vote cast at the election); NEV. CONST. art. XIX, § 2(3) ("majority of the voters voting on such question"); N.D. CONST. art. II, § 25 ("a majority of the votes cast thereon"); OHIO CONST. art. II, § 1b (same); OKLA. CONST. art. V, § 3 (same); OR. CONST. art. IV, § 1(4)(d) (same); WASH. CONST. art. II, §§ 1(d) (amend. 7), 41 (amend. 26) (same, provided that the total vote cast on the measure equals at least one-third of the total vote cast in the election); WYO. CONST. art. III, § 52(f) (initiated measure enacted if receives votes in excess of 50 percent of the total number of votes cast in the preceding general election; referred measure rejected if negative votes in excess of 50 percent of vote in preceding general election). *Cf. e.g.*, Clay v. Thornton, 253 S.C. 209, 169 S.E.2d 617 (1969), *appeal dismissed for want of a substantial federal question sub nom.* Turner v. Clay, 397 U.S. 39 (1970) (cited with approval in Gordon v. Lance, 403 U.S. 1, 7-8 (1971)) (state constitutional provision conditioning incorporation of municipality upon approval of majority of all registered voters therein, not just those voting, upheld); In re Natural Resources Development Bond Act, 47 Ill. 2d 81, 264 N.E.2d 129 (1970)

such a requirement would merely preclude oppression by a localized majority, but not by a dispersed majority. Nevertheless, by making it more difficult to enact legislation by moving the enactment standard closer to the ideal consensus, such a requirement would "provide institutional protection for minority interests, and . . . against governmental intervention into private affairs."[74] A similar effect might be produced by requiring that initiatives be approved in two successive elections, by raising the number of voter signatures required on the initiative petition,[75] or by requiring a geographical distribution on the petition.[76]

B. *Protection Against the Irreparable Destructive Effects of Elections Themselves on Important Values or Interests*

A notion is occasionally found in state constitutions and judicial opinions that the intense scrutiny of values, beliefs, or attitudes engendered by the controversy sometimes accompanying initiative elections may somehow damage these values, beliefs, or attitudes, to the general detriment of society. Such is not the case in elections of governmental representatives, the argument apparently goes, as such elections are inevitably multi-issue affairs. The conclusion reached is that initiatives should be proscribed on issues arousing such destructive tendencies. Two examples of exclusions so rationalized, one constitutional and one judicial, are the exclusion of religious matters from

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(state constitutional provision requiring approval of bond issues by a majority of the votes cast for General Assembly members at same general election upheld).

74 Allen, *supra* note 39, at 1043. This restriction would also aid in meeting objections based on electorate capacities and on protection of efficient government operation.

75 For an argument that this safeguard should be used with restraint, *see* L. TALLIAN, *supra* note 4, at ch. X. Signature requirements in the states range from 5 percent (California, Missouri, Montana, and South Dakota) to 15 percent (Wyoming). *See* Note, *Iniative and Referendum—Do They Encourage or Impair Better State Government?*, *supra* note 4, at 928-29.

76 *See, e.g.*, ALAS. CONST. art. X, § 3 (two-thirds of election districts); ARK. CONST. amend. VII, § 1 (one-half of the required eight percent in 15 counties); D.C. Code § 1-182(a) (five of the city's wards); MD. CONST. art. XVI, § 3(a) (not more than one-half of signature may be residents of Baltimore city or of any one county); MO. CONST. art. III, § 50 (two-thirds of the congressional districts); MONT. CONST. art. III, § 4 (one-third of legislative representative districts); NEB. CONST. art. III, § 2 (two-fifths of the counties); NEV. CONST. art. XIX, § 2(2) (three-fourths of the counties); OHIO CONST. art. II, § 1g (one-half of the required 10 percent in one-half of the counties); WYO. CONST. art. III, § 52(c) (two-thirds of the counties).

initiative reach in Massachusetts[77] and the federal court order in *Otey v. Common Council of City of Milwaukee*[78] enjoining an initiative election at least partly to prevent the racial strife which purportedly would have accompanied that election.

The intent of the drafters of the religious matters exclusion in Massachusetts, as described by R. G. Stewart, was "to limit the public electoral dialogue and lawmaking power to secular, political subjects rather than making the power a vehicle for public discussion of and intrusions into private religious affairs."[79] As so described, the values sought to be protected encompass both freedom to practice one's religion without harassment and separation of church and state. In describing the Massachusetts exclusions in general, Stewart goes on to note that

> as in the case of other exclusions, particularly those pertaining to religion and the judiciary, the reason for excluding . . . matters [pertaining to individual rights under the Massachusetts Declaration of Rights] is not only to prevent enactment, but also to prevent the inevitable heated electoral dialogue about these matters which itself tends to denigrate the rights protected.[80]

In *Otey*,[81] an equal protection challenge was raised to an initiated resolution providing that the council "shall not enact any ordinance which in any manner restricts the right of owners of real estate to sell, lease or rent private property." The court, relying on *Reitman v. Mulkey*,[82] found that the resolution would be unconstitutional as contrary to the equal protection clause. Turning to the issue of relief, the court was impressed with expert testimony to the effect that

> the mere holding of a referendum probably would be dangerous, disruptive and destructive to the community. Moreover, to conduct the referendum would be to slap the cheek of an already unfairly deprived minority group. As to the allegedly educative value of the referendum campaign, as a matter of civic training, the testimony is convincing that

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77 Mass. Const. amend. XLVIII, Initiative, pt. 2, § 2(a).
78 281 F. Supp. 264 (E.D. Wis. 1968).
79 Stewart, *supra* note 23, at 478.
80 *Id.* at 460 n.26.
81 281 F. Supp. at 278; *see also* Bell, *supra* note 33, at 22; Wolfinger & Greenstein, *supra* note 40, at 769.
82 387 U.S. 369 (1967).

> the potential dangers would far outweigh any possible benefits performed by this mode of "education".[83]

Finding a "total absence of any valid reasons against judicial activity," the court held:

> The resolution which is presented to us in this case would be patently unconstitutional if enacted into law. No good reason has been shown for its submission to the electorate. On the other hand. considerable evidence has been presented which convinces the court that the holding of the referendum would do great irreparable injury not only to the plaintiff and his class but to the City as a whole. Under these circumstances submission of the resolution to the electorate must be enjoined.[84]

Exclusions based on rationales such as those underlying the Massachusetts constitutional restrictions and the *Otey* injunction are ill-advised, for several reasons. First, because they remove certain "sensitive" areas from the ambit of the initiative which the representative assemblies remain free to consider, they make the initiative inferior to representative action as a means of legislating.[85]

Second, they carry the implication that public debate of such issues would be of such a quality as to have destructive effects not attending representative debate. If sensitive areas cannot stand the light of public debate, it would not seem to matter whether such debate were in legislative chambers or in the local pub or meeting hall.

Third, even if the legitimacy of such a protective rationale is admitted, principled criteria for exclusion or restriction are not available. Therefore, there is the danger whenever an initiative seems likely to cause civic disruption, that courts will extend *Otey* to enjoin the initiative even though its constitutionality is not really questioned.

Although content regulation is generally undesirable, matters directly pertaining to national security might nevertheless be properly excluded from the initiative and referendum process, especially since secrecy, speed, and a unified plan can be essential in such matters. Although such a categorical exclusion

83 281 F. Supp. at 278 (1968).
84. *Id.* at 279.
85 Bullard v. Osborn, 16 Ariz. 247, 243 P. 117 (1914).

could be subject to abuse through overextension, the drafters of the initiative amendment proposal were apparently convinced of its necessity when they excluded clause 11 (war powers) and clause 15 (suppression of insurrection) congressional powers from the initiative power.[86]

Fourth, the possibility of "appeasement" relief through an extension of the *Otey* decision creates perverse incentives for elements in our society given to violence or intimidation. The implicit message is that the democratic process may be thwarted by veiled threats of violence on the part of those who disagree with a possible result of that process. That such threats or possibilities could influence an individual voter's decision on a "sensitive" issue is cause for concern; that such threats or possibilities could be grounds for aborting the decision-making process is inexcusable, as it invites not only a breakdown of law and order but also a breakdown of the democratic process.

Fifth, even initiative measures later found unconstitutional are nevertheless declarations of voter sentiment, and as such provide signals to legislative representatives (*i.e.*, as advisory plebiscites).

Despite these considerations, the Massachusetts restrictions remain, and several courts have issued pre-election injunctions on the basis of initiative content.[87] It is true, however, that many courts have refused to grant such relief.[88] The concerns underlying the Massachusetts restriction and decisions such as *Otey* might be assuaged somewhat by procedural devices designed to minimize the extent to which initiated measures can

86 S.J. Res. 67, § 1.

87 *E.g.*, Tolbert v. Long, 134 Ga. 292, 67 S.E. 826 (1910); Bowe v. Secretary of the Commonwealth, 320 Mass. 230, 69 N.E.2d 115 (1946); Schultz v. City of Philadelphia, 385 Pa. 79, 122 A.2d 279 (1956); Steen v. Murray, 144 Mont. 61, 394 P.2d 761 (1964); Gray v. Winthrop, 115 Fla. 721, 156 So. 270 (1934); Mathews v. Turner, 212 Iowa 424, 236 N.W. 412 (1931); Baum v. City of St. Louis, 343 Mo. 738, 123 S.W.2d 48 (1938); McCrink v. Town of West Orange, 85 N.J. Super. 86, 204 A.2d 10 (1964); Holmes v. Leadbetter, 294 F. Supp. 991 (E.D. Mich. 1968); Ellis v. Mayor & City Council of Baltimore, 234 F. Supp. 945 (D. Md. 1964), *aff'd and rem'd*, 352 F.2d 123 (4th Cir. 1965).

88 *E.g.*, Ranjel v. Lansing, 417 F.2d 321 (6th Cir. 1969), *reversing* 293 F. Supp. 301 (W.D. Mich.); Spaulding v. Blair, 291 F. Supp. 149 (D. Md. 1968), *aff'd*, 403 F.2d 862 (4th Cir.) (dictum); Yarborough v. City of Warren, 383 F. Supp. 676 (E.D. Mich. 1974); Williams v. Parrack, 83 Ariz. 227, 143 P. 117 (1914); Queen Creek Land & Cattle Corp. v. Yavapai County Bd. of Supervisors, 108 Ariz. 449, 501 P.2d 391 (1972) (except zoning initiative); Horton v. Attorney General, 269 Mass. 503, 169 N.E. 552 (1930); O'Connell v. Kramer, 73 Wash. 2d 85, 436 P.2d 786 (1968).

continue to raise the electorate's collective blood pressure, such as limiting the "debate period"[89] and proscribing repeated petitioning for previously defeated measures.[90]

II. Objections to the Initiative Based on Perceptions of Limited Electorate Capacities

Some initiative opponents doubt that voters are capable of rationally and conscientiously deciding the issues put before them. These doubts are based on beliefs that the electorate will lack (a) the time or the motivation necessary to sufficiently analyze issues, especially when the issues are complex or numerous; (b) the long-range perspective necessary to avoid careening from crisis to crisis;[91] (c) the resources necessary to support comprehensive research of the implications of a given decision; or, (d) the expertise, or access to expertise, necessary to render decisions of adequate quality.

In any event, initiative elections themselves could perform a valuable educative and motivational function for the electorate,[92] serving to remedy the very shortcomings initiative opponents put forth as reasons to withhold the initiative power. If voters are uneducated and unsophisticated as to political issues, the advocacy attending initiative elections could educate them and dispel their naiveté. If voters are not motivated to carefully analyze political issues and if they lack long range perspective, it may be because they realize all the crucial decision-making is being done by their representative "over-

89 *See* note 50 *supra*.

90 *See, e.g.*, Neb. Const. art. III, § 2 (not "oftener [sic] than once in three years"); Okla. Const. art. V, § 6 (not within three years unless by petition of 25 percent of the voters); Wyo. Const. art. III, § 52(d) (not within five years).

91 *See, e.g.* Note, *Initiative and Referendum—Do They Encourage or Impair Better State Government?, supra* note 4, at 941-42.

92 Note, *The Application of the Equal Protection Clause to Referendum-Made Law: James v. Valtierra, supra* note 40, at 410 n.20:

> Proponents [of direct democracy] believed not only that the initiative and referendum would stop legislative corruption and extravagance, but that the popular vote would have an "educational influence upon the electorate" which would leave it with a "higher sense of responsibility and a more vital and personal interest in the state's welfare." (quoting C. Lobingier, The People's Law 343 n.4 (1909));

Allen, *supra* note 39, at 1020; Note, *Initiative and Referendum—Do They Encourage or Impair Better State Government?, supra* note 4, at 939-40.

seers;" once it is clear that the ultimate decision-making authority on given issues is theirs, motivation and perspective may change radically.

To the extent such objections are based on the limited time or resources of the electorate (*i.e.*, on a "division of labor" argument), restriction of the initiative power to general policy-making (as opposed to administering policies) might be appropriate.

Even if objections based on electorate capacities and motivation are assumed valid, regulation of the content of initiated measures beyond that based on the policy-making/policy-administering distinction and the need to exclude national security matters[93] seems an unworkable solution. For example, content regulation, by explicit exclusion or by common law principles developed by the courts, so as to exclude complicated or ill-advised (*e.g.*, having consequences unforeseen by the sponsors) measures would be inappropriate and unworkable. Not surprisingly, the state courts have generally recognized their lack of authority to so regulate ill-advised measures.[94]

Procedural protections have more promise of mitigating an assumed lack of deliberative capacity or motivation on the part of the electorate. Several possibilities might be suggested. First,

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93 *See generally* S.J. Res. 67, § 1.

94 *E.g.*, Sims v. Moeur, 41 Ariz. 486, 493, 19 P.2d 679 (1933) (initiated measure to repeal workmen's compensation law and provide for liquidation of its affairs; "the right of the people to unmake laws, however destructive or ill-advised, is unquestioned"); *see generally* Note, *Limitations on Initiative and Referendum, supra* note 23, at 508; *but see* City of Lawrence v. McArdle, 214 Kan. 862, 871, 522 F.2d 420 (1974) (measure fixing salary classifications for police and firemen in order to equalize their salaries involves "a question more properly determined by administrators with experience and knowledge in the field, than by *a public with little knowledge and less interest*" (emphasis supplied)); Dallas Ry. Co. v. Geller, 114 Tex. 484, 488-89, 271 S.W. 1106 (1925) (dictum) ("The matter of changing, fixing, or regulating the charges, fares, or rates of a public service company . . . , and of determining what the compensation for such service should be and its reasonableness, is . . . in its nature one which is at least impracticable, if not impossible, for the public at large, the voters to pass on. They cannot have or digest the information, data, and facts necessarily incident and essential to the forming of a correct, accurate, and fair judgement upon the subject."); Shriver v. Bench, 6 Utah 2d 329, 333, 313 P.2d 475 (1957) ("issue presents a problem of such complexity that it is not practical for the public to give it sufficient time and attention to make a proper determination of the matter"); Leonard v. City of Bothell, 87 Wash. 2d 847, 854, 557 P.2d 1306 (1976) ("Amendments to the zoning code . . . require an informed and intelligent choice by individuals who possess . . . expertise. . . . In a referendum election the voters may not have an adequate opportunity to read the environmental impact statement or any other relevant information concerning the proposed land-use change.").

an indirect initiative would allow the analytical resources of the Congress to be brought to bear on proposed measures,[95] thus ensuring that the ramifications and implications of such measures would be brought to light. These resources include the Congressional Research Service, committee hearings, and floor debate.

Second, a direct legislation research and drafting service would be of similar assistance.[96]

Third, provision for government-funded publicity[97] and public finance of initiative campaigns,[98] or for equal media access[99] would at least ensure that both proponents and opponents would have equal opportunity to make their views known.

Fourth, a mandatory pre-election debate period would provide time and opportunity for full airing of the issues.

Fifth, requiring a large number of petition signatures[100] or requiring approval by more than a simple majority[101] would screen out many ill-considered proposals.

Sixth, limits on the agenda-setting power by, for example, allowing no more than one subject per petition,[102] would reduce the chances that voters would be overwhelmed by a plethora of initiated measures on the ballot.

A word of caution is in order, however. While these procedural safeguards could serve an important function in improving the quality of initiative legislation, courts should not be permitted to invalidate what they might consider to be ill-advised measures after an election on the grounds of failure to strictly comply with initiative procedures before the election.[103]

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95 LaPalombara & Hagan, *supra* note 73, at 411-12; *see, e.g.*, MASS. CONST. amend. XLVIII, Initiative, pt. III, § 1 (providing for committee hearings and reports on initiated measures).

96 *See* LaPalombara & Hagan, *supra* note 73, at 412.

97 *See* ARK. CONST. amend. VII, § 1; MD. CONST. art. XVI, § 5; N.D. CONST. art. II, § 25; OHIO CONST. art. II, § 1g; WASH. CONST. art. II, § 1(e).

98 *See* note 51 *supra.*

99 *See* note 52 *supra.*

100 *See* note 75 *supra.*

101 *See* note 73 *supra.*

102 *See e.g.*, CALIF. CONST. art. II, § 8(d); OR. CONST. art. IV, § 1(2)(d); MO. CONST. art. III, § 50.

103 Several state constitutions' initiative provisions provide that a post-election finding of a procedural deficiency will not invalidate a measure approved by the electorate. *E.g.*, ARK. CONST. amend. VII, § 1; MONT. CONST. art. III, § 4(3); N.D. CONST. art. III, § 25; OHIO CONST. art. II, § 1g; *cf.* Hart v. King, 470 F. Supp. 1195 (D.C.D. Hawaii 1979) (plaintiffs' failure to seek pre-election relief in federal court barred their post-

Given unequal distribution of resources and skills, some persons or groups will inevitably be better equipped to run campaigns for or against initiated measures. Many commentators feel that special interest groups have been able to dominate state and local initiative elections and "buy" the results they desire,[104] and will be able to do so at the national level.[105] A few others deny that this is the case.[106] It is indeed conceivable that the voters, being more dispersed and diverse than members of legislative bodies, would be more difficult to influence.

Even aside from their relative advantages in resources or skills, however, minorities with intense preferences on particular issues will often prevail over majorities with weak preferences. This is true simply because those with weak preferences have less incentive to make their preferences known and to attempt to persuade others. It is at least arguable that this effect will be most keenly felt in a referendum that focuses on a single issue.

If such special interest dominance is conceded as a possibility, substantive and procedural safeguards might be suggested. If potential for affirmative "abuse" (disproportionate or "undue" influence) by special interests were accepted as a criteria for exclusion from the initiative power, local, private, or special legislation would seem to rank at the top of the list of exclusion candidates. Several states explicitly exclude such legislation from the initiative power,[107] though not without considerable definitional problems.[108]

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election attempt to have the approved constitutional amendments invalidated on the basis of procedural irregularities); Thirty Voters of County of Kauai v. Doi, ___ Haw. ___, 599 P.2d 286 (1979) (same); Barth v. White, 40 Ariz. 548, 553, 14 P.2d 743, 745 (1932) (same); Kerby v. Griffin, 48 Ariz. 434, 444, 62 P.2d 1131 (1936) (same as to initiated statute).

104 *See, e.g.*, Shockley, *The Initiative, Democracy, and Money: The Case of Colorado, 1976*, in *Hearings*, *supra* note 1, at 172-89; S. SATO & A. VAN ALSTYNE, STATE AND LOCAL GOVERNMENT LAW 243-44 (2d ed. 1977); Wolfinger & Greenstein, *supra* note 40, at 767.

105 *Hearings*, *supra* note 1, at 90-102 (testimony of R. Nader); Bell, *supra* note 33, at 20.

106 Allen, *supra* note 39, at 1028-38. "[M]oney . . . is not a dominant factor in determining the outcomes of initiated measures, although . . . well-financed campaigns against a measure may increase its chances of losing." *Id.* at 1035-36.

107 *See* Table 1 in the Appendix; Stewart, *supra* note 23, at 465 (As regards appropriations measures, "the history of [Massachusetts initiative] exclusion indicates that it was designed to halt 'special legislation', narrow special interest appropriations, not general, statewide pass-throughs of public funds.")

108 *See, e.g.*, Boucher v. Engstrom, 528 P.2d 456 (Alas. 1974) (initiative for relocating

Akin to this approach are interest-based restrictions on the franchise which have occasionally been imposed so as to entrust voting power only to those who bear the primary burdens and reap most of the benefits of specialized government activities. Although such restrictions have been upheld in elections of purely special interest,[109] they are generally constitutionally disfavored on equal protection grounds.[110]

Here, however, the national initiative amendment as proposed makes no explicit provision for interest-based restriction, and the issue is thus whether the structure of the federal government or the rights of "interested" voters dictate that such restrictions be imposed by explicit provision, or failing that, by the courts, as to "specialized" issues. Specialized issues might include

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state capitol, which excluded Anchorage and Fairbanks: not local); Walters v. Cease, 394 P.2d 670 (Alas. 1964) (law providing method for incorporating organized boroughs applicable to a few selected localities: local); Opinion of the Justices, 303 Mass. 615, 21 N.E.2d 551 (1939) (law which covers all but two counties: local); Opinion of the Justices, 300 Mass. 602, 14 N.E.2d 462 (1938) (law which in fact applies to one town but is expressed in general language: not local); Opinion of the Justices, 294 Mass. 607, 2 N.E.2d 190 (1936) (law about taxicab permits in cities: local); Town of Mt. Washington v. Cook, 288 Mass. 67, 192 N.E. 464 (1934) (law providing for local option in all towns: not local); Christian v. Secretary of the Commonwealth, 283 Mass. 98, 186 N.E. 38 (1933) (law involving only towns on Boston harbor: local); Opinion of the Justices, 261 Mass. 523, 159 N.E. 55 (1927) (law guaranteeing town bonds by the state government: local); Opinion of the Justices, 254 Mass. 617, 151 N.E. 680 (1926) (apportionment act: local); *see generally* Note, *Limitations on Initiative and Referendum, supra* note 23, at 505-06.

109 *E.g.*, Salyer Land Co. v. Tulare Lake Basin Water Storage Dist., 410 U.S. 719 (1973) (state statute permitting only landowners to vote in water storage district elections upheld); *cf.* Thomas Cussack Co. v. Chicago, 242 U.S. 526 (1917) (municipal billboard neighborhood-consent provision); *see also* cases upholding state statutes operative in a particular locality and contingent upon approval by the voters of that locality, *e.g.*, Wright v. Cunningham, 115 Tenn. 445, 91 S.W. 293 (1905): Bowman v. Virginia State Entomologist, 128 Va. 351, 105 S.E. 141 (1920); or "local option" statutes, *e.g.*, Olds v. State, 101 Fla. 218, 133 So. 641 (1931); Cleveland v. City of Watertown, 222 N.Y. 159, 118 N.E. 500 (1917); In Re School Code of 1919, 7 Boyce (7 Del.) 406, 108 A. 39 (1919).

110 *See, e.g.*, Hill v. Stone, 421 U.S. 289, 297 (1975) (general obligation bond issue held a matter of general rather than special interest even where debt services paid entirely from property taxes); Town of Lockport v. Citizens for Community Action at the Local Level, Inc., 430 U.S. 259 (1977); Krmaer v. Union Free School Dist., 395 U.S. 621 (1969) (vote in certain school district elections limited to owners or lessees of taxable property, their spouses, and the parents or guardians of children who attended district schools); Cipriano v. City of Houma, 395 U.S. 701 (1968) (vote on public utility revenue bonds issuance limited to property taxpayers); City of Phoenix v. Kolodziejski, 399 U.S. 204 (1970) (vote on issuance of general obligation bonds limited to real property taxpayers); L. TRIBE, *supra* note 30, at 765; *cf.* Eubank v. City of Richmond, 226 U.S. 137 (1912) (neighborhood power to establish building set-back lines declared a due process violation); Seattle Title Trust Co. v. Roberge, 278 U.S. 116 (1928) (neighborhood consent needed to construct philanthropic homes for the aged declared a due process violation).

those limited to a certain state or region ("local" legislation, *e.g.*, legislation requiring that all chemical and nuclear wastes be disposed of in New Jersey). Or, specialized issues might include those affecting only certain categories of voters (*i.e.*, those who both bear the burdens and reap the benefits of the government activity involved ("private" laws)). A characteristic of this latter category of specialized issues is that the government is essentially in the role of a contractor, whether the activity is financed by license proceeds (*e.g.*, state wildlife management programs) or by user charges (*e.g.*, toll roads and bridges).

The issue, as one of interpretation, is suggested in the California case of *Chase v. Kalber:*

> [O]nly a comparatively small number . . . must bear the burdens of the proposed improvement; and it is not reasonable to suppose that the people, when enacting the initiative and referendum . . . , intended to vest voters whose property was not to be affected by the proposed improvement or to stand as indemnity for any portion of the burdens thereof . . . with the right to a voice in the matter of the proposed work; for such right in such persons would be directly contrary to the letter as well as the spirit or reason of our street law and to the essential theory upon which the power in the government to coerce the improvement of streets at the expense of the owners of property proceeds.[111]

Explicit or judicial restriction of the initiative by a "specialized act theory," however, might be avoided by the ability of a court to find a general public interest in almost any exercise of the initiative.[112]

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111 28 Cal. App. 561, 575, 153 P. 397, 402 (1915) (writ of mandate to compel referendum on resolution establishing grades of certain street denied); *see also* Hodges v. Board of Improvement, 117 Ark. 266, 174 S.W. 542 (1915) (permanent injunction issued against referendum on ordinance levying assessments of benefits of waterworks against real property); Dallas City v. Steingraber, 321 Ill. 318, 151 N.E. 888 (1926) (referendum power does not apply to ordinances for local improvements (sewer system)); *contra*, Carpenter v. City of Paragould, 198 Ark. 454, 460-63, 128 S.W.2d 980 (1939) (constitutional referendum right applies to legislation of every character, whether the legislation affects all or part of the citizens of the municipality affected; referendum may be had on ordinance providing for issuance of revenue bonds for cost of municipal sewage disposal plant and on resolution accepting bid for construction of the plant and fixing rates and charges for connection therewith).

112 *See, e.g.*, James v. Valtierra, 402 U.S. 137, 143 n.4 (1971) (community interest in construction of low-rent housing found on basis of need to provide services to residents, despite the fact that city would receive ten percent of the housing projects' rentals); City of Eastlake v. Forest City Enterprises, Inc., 426 U.S. 668, 673 n.7 (1976)

More effective, perhaps, would be efforts to neutralize the resource disparity, although this would not, of course, remove the "intensity of preference" problem. The several procedural protections discussed above are possibilities: (a) an equal media-access rule;[113] (b) initiative campaign-finance regulation (*e.g.*, contribution or expenditure limits or disclosure requirements);[114] or, (c) public financing of initiative campaigns.[115] Attempts to equalize access to the initiative and to initiative voters and to increase the barriers to passage could also mitigate to some extent any special problems inhering in the initiative process for minorities and the poor (as discussed above).

III. OBJECTIONS TO THE INITIATIVE BASED ON INSTITUTIONAL OR STRUCTURAL GROUNDS

Objections of this type are based on concerns about potential problems arising from the absence of opportunity for compromise on initiated measures and from possible interference with efficient government operation.

A. *Absence of Compromise*

There are two types of compromise: (1) compromise on a particular measure, and (2) compromise where support for one bill is traded for support on another bill (*i.e.*, "log-rolling"). By the very nature of the initiative, opportunities for pre-election negotiation and compromise between groups with diverse positions are minimal.[116] Negotiation and compromise no doubt aid in building a consensus of support behind a measure. It is

(land-use change would likely entail provision of additional city services and diminish the land area available for industrial purposes).

113 *Hearings, supra* note 1, at 90-102 (testimony of R. Nader); *see* Red Lion Broadcasting Co., Inc. v. F.C.C., 395 U.S. 367 (1969) (upholding requirement of F.C.C. that political candidates be afforded an opportunity to reply to broadcast attacks or editorials); note 52 *supra*.

114 *Hearings, supra* note 1, at 90-102, 172-89 (testimony of R. Nader; Shockley, *The Initiative, Democracy, and Money: The Case of Colorado, 1976*); *see* note 51 *supra; see also* First Nat'l Bank of Boston v. Belloti, 435 U.S. 765 (1978), *reh.den.* 438 U.S. 907 (1978). Buckley v. Valeo, 424 U.S. 1 (1976); Burroughs and Cannon v. United States, 290 U.S. 534 (1934); L. TRIBE, *supra* note 30, at 800-09.

115 *Hearings, supra* note 1, at 172 (J.S. Shockley letter).

116 Wolfinger & Greenstein, *supra* note 40, at 758, 768.

debatable, however, whether compromised decisions are always "better" or more "desirable."[117]

To the extent the initiative process affords no opportunity for building coalitions of support through compromise, many voters are effectively excluded from the process of legislative decision-making (more accurately, from the legislation drafting process).[118] This exclusion might be reflected, to some extent, in the quality and rate of approval of initiated legislation, and in the consistency of such legislation with existing laws and practices. These effects could be mitigated to some degree, however, by the protections offered by the due process clause.[119] Part of the rationale underlying due process is the notion that one may not be deprived of life, liberty, or property by focused governmental action without first being allowed to have contact with and to interact with the relevant decision-makers (*e.g.*, participate in a hearing). The interaction afforded by a "hearing" allows the affected individual to propose compromises to those persons having the power or authority (at least to a minimal extent) to bargain over outcomes.[120] For example, the due process clause requires the disciplinarian "to inform [a student about to be suspended] of his dereliction and to let him tell his side of the story in order to make sure that an injustice is not done."[121]

From such a due process perspective, initiatives should be precluded whenever focused governmental actions significantly and adversely affecting an individual's life, liberty, or property

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117 *See generally, Hearings, supra* note 1, at 162 (letter from Prof. A.S. Miller, George Washington University Law School: "Congressional statutes are often hammered out on the anvil of compromise; and thus tend to reach a low common denominator.").

118 Bell, *supra* note 33, at 14.

119 *See* general discussion of the due process clause as applied to initiative in text accompanying notes 41 to 53 *supra*.

120 *See* L. TRIBE, *supra* note 30, at 550 (discussing the participatory role of due process, Professor Tribe notes "the intrinsic importance of due process as providing a right to dialogue between government and the individual so that each person can participate in the focused, adverse decisions of governmental bodies—a right implicit in bill of attainder notions as well as in due process.").

121 Goss v. Lopez, 419 U.S. 565, 580 (1975); *see also* Ingraham v. Wright, 430 U.S. 651, 676 (1977) (Although not as accommodating to procedural safeguards as in *Goss*, the Supreme Court, in considering corporal punishment in the schools, recognized that "the child has a strong interest in procedural safeguards that minimize the risk of wrongful punishment and provide for the resolution of disputed questions of justification."); Joint Anti-Fascist Refugee Comm. v. McGrath, 341 U.S. 123 (1951).

are contemplated. Such preclusion could have the effect of protecting individual due process "bargaining rights" when they are most crucial. Determination of when a governmental action is "focused" or "specific" enough to warrant such protection would implicate the administrative/legislative distinction (see discussion below).

Beyond this due process approach, explicit categorical exclusion from the initiative power is not a viable remedy for absence-of-compromise problems, for the need for compromise is not confined to, or especially urgent in, any specific issue areas. A procedural means of addressing the compromise problem would be to provide for indirect initiative, with authority given Congress to submit alternative, compromise measures for the initiated proposal.[122] This would only be a partial solution, however, since it would not address the absence of the logrolling type of compromise.

B. *Interference with the Efficient and Consistent Operation of Government*

Concern that the initiative power will hinder governmental decision-making and operations may be said to rest to some extent on a division of labor argument. The argument is that the people have delegated legislative power to a representative assembly not so much because they fear the effects of untrammeled majoritarian decision-making on minority groups and not so much because they believe themselves incapable of adequately legislating, but because they recognize the economies and consistency to be achieved by centralizing the legislative task. According to the argument, delegation of legislative power

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122 *See, e.g.*, ME. CONST. art. IV, pt. III, § 18; MASS. CONST. amend. XLVIII, Initiative, pt. III, § 2; MICH. CONST. art. II, § 9; NEV. CONST. art. XIX, § 2(3); OHIO CONST. art. II, § 1b (proposed measure is submitted to legislature upon petition of three percent of voters; if amended or not passed by the legislature, measure is submitted to election upon petition of an additional three percent of the voters, in its original form or incorporating amendments suggested by the legislature); WASH. CONST. art. II, § 1(a); *see also* MASS. CONST. amend. XLVIII, Initiative, pt. V, § 2 (providing for amendment of an initiated measure by its petitioners, if the change is "perfecting in its nature and does not materially change the substance of the measure").

The electorate can also offer compromise alternatives, a tactic which is facilitated by the notice provided by a pre-petition application requirement. *See, e.g.*, ALAS. CONST. art. XI, § 2; WYO. CONST. art. III, § 62(b).

is thus spurred by the limitations noted above on electorate time and resources available to analyze proposed legislation. In addition, legislators are able to develop a certain amount of expertise, and are more easily petitioned and "educated" (*i.e.*, lobbied) than the electorate.[123] Once this perspective is accepted, two additional objections to the initiative might be raised: (1) that decision-making via the initiative sacrifices the economies, expertise, and consistency of centralized legislating; and (2) that a decline in the quality of representatives' work might accompany the diminishing responsibility of the legislature in a mixed direct/representative system.[124]

To both the efficiency and consistency objections it could be countered that more democratic decision-making will always be less efficient and consistent than representative decision-making. But, the efficiency and consistency objections to the initiative power must be balanced against potential benefits such as the personal growth of individuals, more widespread acceptance (or at least tolerance) of the law, and the feeling of "commonality" that might accompany increased participation in governmental decision-making. Also, the initiative is often advocated more as a check on representative legislation than as a substitute for it.[125] Under this conception, the initiative is available to be used whenever the legislature is unresponsive to the people's wishes, and is seldom used otherwise.

Nevertheless, assuming the efficiency and consistency objections are valid, the initiative's scope may be limited so as to preserve efficiency and consistency. Restrictions on initiative measures may be justified by two means: application of the

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123 *See* Note, *Initiative and Referendum—Do They Encourage or Impair Better State Government?*, *supra* note 4, at 940.

124 *Id.* at 941; *see* Smith, *The Referendum and Its Uses,* 10 CONST. REV. 21, 26 (1926); Note, *Constitutionality of the Referendum,* 41 YALE L.J. 132, 134 (1931); *but see* Allen, *supra* note 39, at 1041-42 n.374; LaPalombara & Hagan, *supra* note 73, at 404-06.

125 Nolan v. ClenDening, 93 Ohio St. 264, 277-78, 112 N.E. 1029 (1915):

> The potential virtue of the 'I. & R.' does not reside in the good statutes and good constitutional amendments initiated, nor in the bad statutes and bad proposed constitutional amendments that are killed. Rather, the greatest efficiency of the 'I. & R.' rests in the wholesome restraint imposed automatically upon the general assembly and the governor and the possibilities of that latent power when called into action by the voters.

See also Note, *Initiative and Referendum—Do They Encourage or Impair Better State Government?*, *supra* note 4, at 939.

separation-of-powers doctrine and interpretation of the term "laws."

1. *Separation of Powers Doctrine.* Because initiative measures are legislative in nature, the separation of powers doctrine provides a basis for courts to strike down initiated measures concerning executive or judicial functions. Several states have specifically stated that judicial matters are not included among the categories subject to initiative measures.[126] On the federal level, the proscription of bills of attainder, which is arguably motivated by separation-of-powers concerns,[127] would preclude use of initiatives to directly reverse an acquittal of a criminal defendant or a verdict in a civil case. The separation-of-powers doctrine could be extended further to preclude initiative measures for selection or recall of judges. Categorical limitation of judicial jurisdiction, such as initiative measures against abortion or busing, would also be subject to attack under a separation-of-powers doctrine.[128]

2. *Interpretation of the Term "Laws."* The national initiative amendment, as proposed in Senate Joint Resolution 67, provides that the people shall have the power to propose and enact "laws." Interpretation of the term "laws" provides the courts with a device for limited or expansive reading of the initiative's scope. "Laws" could be limited to measures of general application, that is, rules themselves as opposed to applications of rules previously decided upon.[129] A narrow reading of the term "laws," however, might also be used to preclude resolutions or declarations of policy by the people.[130] This would be an unfortunate outcome. Resolutions or declarations of policy have

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126 *See* Table 1 in the Appendix.

127 U.S. CONST. art. I, § 9, cl. 3. *See* L. TRIBE, *supra* note 30, at 491-99.

128 *Cf. e.g.*, cases holding that attempts to restrict the legislative power by initiative are invalid, Campden v. Greiner, 15 Cal. App. 3d 836, 93 Cal. Rptr. 525 (1971); McCrink v. Town of West Orange, 85 N.J. Super. 86, 204 A.2d 10 (1964); *cf. also* Otey v. Common Council, 281 F. Supp. 264, 274 n.17 (E.D. Wis. 1968) ("a legislature cannot be statute irrevocably withdraw a topic from the scope of future legislation; that is, a legislature cannot irrevocably bind its successors"); *see, e.g.*, H. L. A. HART, THE CONCEPT OF LAW 146-47 (Oxford U. Press 1961).

129 *See* West v. City of Portage, 392 Mich. 458, 465, 221 N.W.2d 303 (1974) ("The words 'initiative' and 'referendum' are themselves an implicit limiation on the matters that may properly be the subject of an initiative or referendum. . . .").

130 *Cf.* Ex parte Hague, 105 N.J. Eq. 134, 147 A. 220 (1929); Koenig v. Flynn, 258 N.Y. 292, 179 N.E. 705 (1932); *but see* state constitutional initiative provisions which include resolutions in the "measures" that may be enacted by the people, *e.g.*, ARK. CONST. amend. VII, § 1; N.D. CONST. art. II, § 25.

sometimes been used when the political entity involved would not have authority to enact binding legislation on the subject in question. For example, in *Farley v. Healey*, the initiated measure provided that "[i]t is the policy of the people of the City and County of San Francisco that there be an immediate cease fire and withdrawal of U.S. troops from Vietnam so that the Vietnamese people can settle their own problems."[131] Resolutions or declarations of policy could also be used, however, when the people wished to express a government policy but, for example, wished to defer to the expertise and resources of the Congress for implementation of that policy, or, knowing that specific legislation implementing a policy would be ineffective (or even be found unconstitutional), wished only to send a message to the executive branch or the administrative agencies regarding the manner in which they should proceed in a given area.

The separation-of-powers doctrine and interpretation of the term "laws" could be used, as well as interest-based restrictions, as bases for the exclusion of administrative matters from the national initiative power[132] in order to protect the efficiency and consistency of government action.[133] Administrative matters are said to be those which merely execute a law already in existence rather than setting out government policies, plans, or

131 67 Cal. 2d 325, 431 P.2d 650, 62 Cal. Rptr. 26 (1967); *contra*, Silberman v. Katz, 54 Misc. 2d 956, 283 N.Y.S.2d 895 (1967), *aff'd mem.*, 28 A.D.2d 992, 284 N.Y.S.2d 836 (1967); Rhodes v. Board of Elections of Lake County, 12 Ohio St. 2d 4, 230 N.E.2d 347 (1967); Amalgamated Transit Union-Division 757 v. Yerkovich, 24 Or. App. 221, 545 P.2d 1401 (1976) (initiated measure "approving"—in effect, requesting—construction of a certain freeway held not subject to referendum).

132 For derivation of the administrative/legislative distinction from interpretation of the term "laws," *see* Note, *Limitations on Initiative and Referendum, supra* note 23, at 503; *but cf.* Katter, Inc. v. Brockman, 349 S.W.2d 838 (Ky. 1961) (administrative/legislative distinction irrelevant where statute conferring referendum power refers to "every ordinance or resolution").

Although some commentators confine the administrative matters exclusion "to actions of local governments in which the administrative and legislative functions are combined in one body," Note, *Limitations on Initiative and Referendum, supra* note 23, at 503; *see also* 42 AM. JUR. 2d *Initiative and Referendum* § 11, at 659 (1969 § Supp. 1980); such does not seem to be the case universally. Moreover, exclusion of local, special, or private laws may be based on the same rationale and perform the same function at the state level as the administrative matters exclusion at the local level. *See generally* Note, *Limitations on Initiative and Referendum, supra,* note 23, at 505-06.

133 *See, e.g.*, City of Newport v. Gugel, 342 S.W.2d 517, 520 (Ky. 1960); Kelley v. John, 162 Neb. 319, 323-24, 75 N.W.2d 713 (1956) (zoning amendment); Ballantyne v. Leeman, 149 Neb. 847, 32 N.W.2d 918 (1948); Keigley v. Bench, 97 Utah 69, 89 P.2d 480 (1939).

purposes anew;[134] which may be properly classed among the executive powers;[135] or, which relate to temporary measures controlled by fluctuating circumstances rather than permanent measures of governmental policy.[136] Definition of what matters are administrative is more simply stated than applied.

At least two examples of exclusions which could result from application of the administrative/legislative distinction to the national initiative power are available.

1. *Initial Measure in a Necessary Series.* When a series of measures is necessary to implement a government policy, action, or public improvement, only the initial measure in the series (*e.g.*, a resolution of necessity) might be considered legislative.[137] Local zoning decisions provide an apt analogy. In this area, most courts hold that enactment of a comprehensive plan is the only legislative decision involved,[138] with any further decisions (*e.g.*, rezoning or amendment of the plan or variances) characterized as administrative.[139]

2. *Advice and Consent on Treaties and Executive Appointments.* A legislative-structure problem similar to that arising with regard to revenue measures is created by the Constitution's provision for Senate "advice and consent" on exercises of the

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134 *E.g.*, E. McQuillan, *supra* note 43, at 255; *accord, e.g.*, Seaton v. Lackey, 298 Ky. 188, 182 S.W.2d 336 (1944); Keigley v. Bench, 97 Utah 69, 89 P.2d 480 (1939).

135 E. McQuillan, *supra* note 43, at 255, *cited in, e.g.*, Whitehead v. H and C Dev. Corp., 204 Va. 144, 150, 129 S.E.2d 691 (1963) (new rate schedule for water service connections involves administrative decision).

136 *E.g.*, Hawkins v. City of Birmingham, 248 Ala. 692, 29 So. 2d 281 (1947) (ordinance establishing three-platoon system for city fire department may be submitted to a plebiscite); Monahan v. Funk, 137 Or. 580, 3 P.2d 778 (1931); Keigley v. Bench, 97 Utah 69, 89 P.2d 480 (1939); Whitehead v. H and C Dev. Corp., 204 Va. 144, 129 S.E.2d 691 (1963).

137 *E.g.*, Valentine v. Town of Ross, 39 Cal. App. 3d 954, 114 Cal. Rptr. 678 (1974) (decision to join county flood control district and to approve schematic plans for flood control project was legislative; subsequent approval of district's finalized plans was administrative); Whitehead v. H and C Dev. Corp., 204 Va. 144, 129 S.E.2d 691 (1963).

138 *E.g.*, Fleming v. City of Tacoma, 81 Wash. 2d 292, 299, 502 P.2d 327 (1972).

139 *E.g.*, West v. City of Portage, 392 Mich. 458, 221 N.W.2d 303 (1974) (zoning amendment); Kelley v. John, 162 Neb. 319, 75 N.W.2d 713 (1956); Bird v. Sorenson, 16 Utah 2d 1, 394 P.2d 808 (1964). Leonard v. City of Bothell, 87 Wash. 2d 847, 557 P.2d 1306 (1976); *contra* (rezoning or amendment) Johnston v. City of Claremont, 49 Cal. 2d 826, 323 P.2d 71 (1958); Dwyer v. City Council, 200 Cal. 505, 253 P. 932 (1927); Denney v. City of Duluth, 295 Minn. 22, 202 N.W.2d 892 (1972); Wollen v. Borough of Fort Lee, 27 N.J. 408, 142 A.2d 881 (1958); Smith v. Township of Livingston, 106 N.J. Super. 444, 256 A.2d 85 (1969); Forest City Enterprises, Inc. v. City of Eastlake, 41 Ohio St. 2d 187, 324 N.E.2d 740 (1975), *rev'd on other grounds*, 426 U.S. 668 (1976); Hilltop Realty, Inc. v. City of South Euclid, 110 Ohio App. 535, 164 N.E.2d 180 (1960).

Presidential power to make treaties and appoint federal officials.[140] While negotiation of treaties and selection of appointees seems clearly an executive (*i.e.*, administrative) function, the Framers of the Constitution apparently regarded "advice and consent" as a legislative function. Whether the courts would accept this interpretation, or whether they would find the initiative to be inconsistent with the constitutionally mandated procedure, apart from the administrative/legislative distinction, is open to debate. Here, an explicit inclusion or exclusion in the amendment proposal would be critical.

Two additional considerations with regard to the efficiency and consistency of the national initiative should be noted. First, the initiative amendment's explicit exclusion of the war powers and the power to suppress insurrection[141] may be motivated to some extent by the same concerns for efficacious and consistent government action underlying the exclusion in some of the states of "safety" or "emergency" legislation (*i.e.*, legislation necessary for the immediate preservation of the public peace, health, or safety).[142] The national initiative, however, could apparently be used to repeal legislation which would be defined by the states as safety or emergency legislation (*e.g.*, a gas rationing bill, an act authorizing wage and price controls, or an act requiring peacetime draft registration), so long as the legislation did not involve the exercise of the war powers or the power to suppress insurrection. The war-powers and suppression-of-insurrection exclusions thus seem to reflect a desire to yield to the efficiency and consistency concerns only where absolutely necessary, *i.e.*, where the nation's security could be affected adversely. Moreover, the concerns underlying these exclusions would seem to go beyond mere efficiency and consistency to considerations of the very nature in which national security matters must often be handled, involving secrecy and dispatch. A national security exclusion could be subject to abuse. Given the necessity for such an exclusion, however, we will have to rely in the final analysis on the courts to police its parameters.

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140 U.S. CONST. art. II, § 2, cl. 2.
141 S.J. Res. 67, § 1.
142 *See* Table 1 in the Appendix.

Second, changes in the initiative procedure to make it more efficient would tend to be inconsistent with procedural changes to deal with the problems connected with voter motives and capacities discussed above. This is because changes to make the process more streamlined might remove the time consuming safeguards designed to protect minority rights and to ensure time for voter education and reflection on initiative proposals. For example, an indirect initiative process or a mandatory pre-election debate period would lengthen the time from conception of a proposal to the vote on it, but might be desirable to ensure that the implications of a given proposal are fully aired and considered by the electorate.

Conclusion

In light of the increasing popularity of direct democracy in the states, the national initiative amendment may be ripe for ratification. Objections to this form of direct democracy can be met by building substantive restrictions and procedural safeguards into the initiative power. These safeguards should be imposed with restraint so as to preserve the vitality of the initiative. Some safeguards should be explicitly provided in the initiative amendment, while others could proceed from judicial interpretation of the amendment's language and intent. Additionally, measures enacted through the initiative should be accorded status equal to that of congressional legislation, and thus be subject to the same constitutional limitations as congressional legislation. Further checks against abuses of the initiative power could be provided by making the President's veto power applicable to approved initiated measures and by allowing congressional amendment or repeal of such measures.

Of the three general categories of objections to the initiative power, the first is based on perceived threats to individual rights or other basic values. Protection of minorities against majoritarian abuse of the initiative might be afforded by the due process clause (especially in its application to exclude administrative matters), by an indirect initiative process, by a mandatory pre-election debate period, by initiative campaign finance leg-

islation, by provision for equal media access, by a requirement that the initiated measure be approved by more than a simple majority, by a requirement of approval in two successive elections, by raising the required number of petition signatures, or by requiring the petition signatures to be geographically dispersed. Explicit exclusions or pre-election injunctions based solely on a desire to protect cherished values from the "destructive" effects of initiative campaigns are not only ill-advised as denigrating the initiative power and public debate, but also lack a principled basis.

The second set of objections to the initiative is based on fears of limited voter capacities. Initiative-content regulation as a means to deal with a perceived "uninformed voter" problem seems an unworkable solution. If an "uniformed voter" problem does exist, it is better remedied by the administrative-matters exclusion and by such procedural devices as an indirect initiative process, provision for government subsidized publicity for both sides of issues, a direct legislative research and drafting service, a mandatory pre-election "debate period," restraint of the "agenda-setting" power, or a requirement that the measure be approved by more than a simple majority. Special interest group dominance of initiative elections might be countered by exclusion of "specialized" legislation, by procedural devices designed to equalize access to the electorate and to the initiative-drafting process, or by increasing the barriers to passage.

With respect to the third set of objections, those based on institutional or structural grounds, problems caused by the inability to compromise on initiated measures might be mitigated by excluding administrative matters, or by an indirect initiative procedure, with authority for Congress to submit alternate, "compromise" measures. The efficiency and consistency of government action could be protected by judicial application of the separation-of-powers doctrine, of a narrow interpretation of the term "laws," or of a "specialized act theory." Elements of each of these theories are implicit in the administrative/legislative distinction, which could be a powerful judicial tool for the protection of governmental efficiency and the ensuring of consistent development and application of the law.

Although excessive complexity should be avoided in the

amendment, it seems preferable to set out any desired restrictions and safeguards in the terms of the amendment rather than relying upon the uncertain judicial development of restrictions. With built-in safeguards, the national initiative could prove a satisfactory means of effecting a quantum increase in citizen participation in the federal government.

Appendix

The National Initiative Constitutional Amendment, as proposed in S.J. Res. 67:

"ARTICLE

"SECTION 1. The people of the United States shall have the power to propose and enact laws in accordance with this article, except with respect to carrying out the powers granted to Congress in clauses 11 and 15 of article 1, section 8, of this Constitution. This article does not grant the people of the United States the power to propose amendments to this Constitution.

"SECTION 2. A law is proposed by presenting to the chief law enforcement officer of the United States a petition that sets forth the text of the proposed law and contains signatures, collected within the eighteen months prior to such presentation, of registered voters equal in number to three per centum of the ballots cast in the last general election for President and which includes the signatures of registered voters in each of ten States equal in number to three per centum of the ballots cast in the last general election for President in each of the ten States. Within ninety days of such presentation, the chief law enforcement officer of the United States shall determine the validity of the signatures contained in such petition through consultation with the appropriate States. Upon a determination that such petition contains the required number of valid signatures, he shall certify such petition. He shall then direct that the proposed law be placed on the ballot at the next general election held for choosing Members of the House of Representatives occurring at least one hundred and twenty days after such certification. The Congress shall provide by law reasonable procedures for the preparation and transmittal of such petitions, and for the certification of signatures on such petitions. For the purposes of this section, the term 'State' shall include the District of Columbia.

"SECTION 3. A proposed law shall be enacted upon approval by a majority of the people casting votes with respect to such proposed law and shall take effect thirty days after such approval except as otherwise provided in the proposed law. Any law enacted pursuant to this article shall be a law the same as any other law of the United States, except that any law to repeal or amend a law enacted pursuant to this article during the two years immediately following its effective date must receive an affirmative rollcall vote of two-thirds of the Members of each House duly elected and sworn. No law, the enactment of which is forbidden the Congress by this Constitution or any amendment thereof, may be enacted by the people under this article.

"SECTION 4. The Congress and the people shall have the power to enforce this article by appropriate legislation."

TABLE 1
SUBSTANTIVE CONSTITUTIONAL RESTRICTIONS ON THE SCOPE OF INITIATIVE AND REFERENDUM IN THE STATES
(I: Initiative so restricted; R: Referendum so restricted)

	None	Appropriations	Special, private, local laws	Judicial matters	Safety, emergency legislation	Tax levies
Alaska		I, R	I, R	I	R	
Ariz.	I	R			R	
Ark.	I, R					
Cal.*		R	I, R		R	R
Colo.	I	R			R	
D.C.*		I, R			R	R
Idaho	I, R					
Maine*	I				R	
Md.(R only)*		R				
Mass.*		I, R	I, R	I, R		
Mich.	I	R				
Mo.		I, R			R	
Mont.		I, R	I			
Neb.	I	R				
Nev.*	R					
N.M.(R only)*		R	R		R	
N.D.	I, R					
Ohio*		R			R	R
Okla.	I				R	
Or.*	I				R	
S.D.*	I				R	
Utah*	I					
Wash.	I	R			R	
Wyo.		I, R	I, R	I	R	
Totals	I: 13 R: 4	I: 6 R: 15	I: 5 R: 5	I: 3 R: 1	R: 14	R: 3

* *Miscellaneous Exclusions:*

California (R): "statutes calling elections"

District of Columbia (R): "if it has become law according to the provisions of s. 1-144 [not disapproved 30 days after submission to the House and Senate or the President]"

Maine (R): "such orders or resolutions as pertain solely to facilitating the performance of the business of the Legislature, of either branch, or of any committee or officer thereof, or appropriate money therefor or for the payment of salaries fixed by law"

Maryland (R): "no law, licensing, regulating, prohibiting, or submitting to local option the manufacture or sale of malt or spirituous liquors"

Massachusetts (I, R): (1) "relates to religion, religious practices or religious institutions;" and (2) "inconsistent with any one of the following rights of the individual, as at present declared in the declaration of rights, . . . : the right to receive compensation for private property appropriated to public use; the right of access to and protection in courts of justice; the right of trial by jury; protection from unreasonable search, unreasonable bail and the law martial; freedom of the press; freedom of speech; freedom of elections; and the right of peaceable assembly."

(I): (1) "No part of the constitution specifically excluding any matter from the operation of the popular initiative and referendum shall be the subject of an initiative petition; nor shall this section be the subject of such a petition." (2) "Neither the eighteenth amendment of the constitution [free exercise of religion; use of public money,

property, or credit for private schools, hospitals or institutions or churches] . . . nor this provision for its protection"

Nevada (I): "makes an appropriation or otherwise requires the expenditure of money, unless such statute or [statutory] amendment also imposes a sufficient tax, not prohibited by the constitution, or otherwise constitutionally provides for raising the necessary revenue."

New Mexico (R): (1) "providing . . . for the payment of the public debt or interest thereon, or the creation or funding of the same;" and (2) "providing . . . for the maintenance of the public schools or state institutions"

Ohio (I, R): "law authorizing any classification of of property for the purpose of levying different rates of taxation thereon or of authorizing the levy of any single tax on land or land values of land sites at a higher rate or by a different rule than is or may be applied to improvements thereon or to personal property"

Oregon (I): legislation calling a constitutional convention

South Dakota (R): "necessary for . . . support of the state government and its existing public institutions"

Utah (R): "laws passed by a two-thirds vote of the members elected to each house of the legislature"

RECENT PUBLICATIONS

THE COURT YEARS 1939-1975: THE AUTOBIOGRAPHY OF WILLIAM O. DOUGLAS. New York: Random House, 1980. Pp. 394, appendices, index, illustrated. $16.95.

In 1974, William O. Douglas published the first volume of his autobiography, *Go East, Young Man.* In that book he retraced his "early years," recounting his coming of age in Yakima, Washington, his growing appreciation of nature, his "riding the rails" east to Columbia Law School in 1922, and his years on the Securities and Exchange Commission (1934-39). *The Court Years,* the second volume of his autobiography, is less a continuation of the earlier work than it is a collection of essays on the famous judges and politicians Douglas knew, the Supreme Court's changing philosophy of the Constitution, Douglas' own philosophy, and his thoughts on American history from 1939 to 1975. Douglas, in *The Court Years,* is willing to express an opinion on virtually everything he experienced and everybody he met during his tenure on the Court — and indeed the book is fascinating and quite entertaining in this respect — but he tells little of his own life. There is no mention, for instance, of his daily routine, his controversial married life, or his children.

The Court Years sheds some light on the inner workings of the Supreme Court during Douglas' years there. For example, he describes the behavior of members of the Court during conferences on particular cases (such as the Rosenberg case, pp. 78-82). The idiosyncrasies of particular Justices are also detailed.

Only a few years ago when Woodward and Armstrong published *The Brethren,* cries went up that the majesty and authority of the Supreme Court and respect for its decisions would be diminished by public exposure of the human, sometimes petty, behavior of the Justices. Douglas' book, published only about a year after *The Brethren,* often follows the Woodward-Armstrong style of journalism, yet ironically, no one has raised similar objections concerning *The Court Years.* Apparently, the identity of the reporter, not the content of the report, is the crucial factor separating destructive accounts of the Court from benign ones.

Toward the end of the book, Douglas sets out to show that the present Supreme Court, far from being overworked, is ac-

tually underworked. He shows that it is currently writing fewer opinions and sitting for less time to hear arguments than it did during the time of Chief Justice Hughes, the first Chief Justice under whom Douglas served (pp. 384-86). Douglas contends that the hue and cry for reducing the Court's current workload is really a disguised way of preventing the Supreme Court from enforcing "'constitutional' law and order" as opposed to Nixonian "law and order" (p. 386).

Douglas is also concerned that the Supreme Court is overstaffed with law clerks: "Under the Burger Court many law clerks did much of the work for the Justices, and that was not right. A Justice is confirmed for what he appears to be; it is his personal decision that is constitutionally required" (p. 175). At one point, during Chief Justice Earl Warren's tenure, Douglas even went so far as to propose that all law clerks be abolished: "'For one year,"I pleaded, 'why don't we experiment with doing our own work? You all might like it for a change'" (p. 172). The proposal, Douglas reports, "was met by a few smiles but mostly stony silence" (*Id.*).

Justice Douglas died before the publication of *The Court Years*. This was indeed unfortunate, for though the greater part of *The Court Years* had been written by 1973 (p. ix), the book never received the literary polish apparent in the earlier volume of his autobiography and much of Douglas' legal writing. Chapters often lack coherence. For example, in the chapter entitled "The Court and Big Business," the text rambles from discussing one line of cases to another, the only apparent connection being the fact that big business was usually on the winning side in the cases. As further evidence of poor editing, incidents recounted early in the book are frequently repeated in later chapters. On pages 69-70, for instance, Douglas discusses an "interesting historical episode" in which President Truman issued an Executive Order in 1948 which prohibited the FBI from turning over to Congress a security report on the Director of the National Bureau of Standards, Dr. Edward Condon. Congressman Richard Nixon rose on the House floor to challenge the constitutionality of such an order, stating: "That would mean that the President could have arbitrarily issued an Executive Order in the Meyers case, the Teapot Dome case, or any other case denying the Congress of the United States information it needed to conduct an investigation of the executive

department and the Congress would have no right to question his decision." This episode is retold, using the same quotes, on pages 345-46.

Despite occasional editorial lapses, *The Court Years* is certainly a book worth reading, because it illuminates Douglas' often misunderstood or misrepresented philosophy of life and the law. In addition, as an added bonus, *The Court Years* contains an appendix wherein the United States Constitution is reproduced. Whether this appendix was added by the publishers on their own initiative or at Justice Douglas' request (perhaps Douglas did not want to be outdone by his close friend Hugo Black in his fidelity to that document), it undoubtedly makes *The Court Years* the lightest volume on any lawyer's or legislator's bookshelf to reach for when the text of the Constitution needs to be consulted.

Carlton M. Smith

FRIENDLY FASCISM: THE NEW FACE OF POWER IN AMERICA. By *Bertram Gross*. New York: M. Evans and Company, 1980. Pp. ix, 420, notes, index. $15.00.

In *Friendly Fascism,* Bertram Gross seeks to examine "the new face of power in America." He argues that the ultimate result of World War II, in which America defeated the forces of "classic fascism" and gained world dominance, has been to create excessive concentrations of wealth and power in the American elite class. Such concentrations of power undermine the democratic process, permit exploitation of minorities and the poor, and, ultimately, threaten basic liberties.

In assessing the future, Gross sees "[a] new despotism creeping slowly across America" (p. 1). In this bleak vision, "[f]aceless oligarchs sit at communal posts of a corporate-government complex that has been slowly evolving over many decades. In efforts to enlarge their own powers and privileges, they are willing to have others suffer the intended or unintended consequences of their institutional or personal greed" (*Id.*). The most insidious aspect of this process, Gross argues, is that such encroachments on democracy are gradual and extremely difficult to perceive. These fascists are not the extremists of the World War II era, but rather, are rational, respectable individuals who serve as

the wards of corporate and governmental power in America. Subversion of democracy occurs not through terror, but by silent consolidation of capital and influence over state decisions. Gross argues that "[t]he combined influence of institutional rigidities, traditional concepts of constitutional democracy, and rifts among powerful elites is so great that friendly fascism could hardly emerge other than by gradual and silent encroachments" (pp. 167-68).

"Friendly fascism" is international in scope, observable as well among America's partners in Japan and Western Europe. Corporate forces in this trilateral alliance are extending their influence transnationally to achieve neo-colonial domination in many third world countries. Gross argues that as a result of consolidation of corporate power in developed countries, "constitutional rights have been thoroughly suppressed in many dependent countries" (p. 34). While "friendly fascism" has yet to reach its peak in America and other developed countries, the trends toward consolidation of power, opinion manipulation, and subversion of democratic processes are well entrenched. Full development of the "friendly fascist state" can only be prevented, Gross contends, by efforts to prevent excessive concentration of wealth among elites and, in some cases, by nationalization of corporate power. Moreover, governmental power must be decentralized and decision-making power returned to states and localities, so that individuals can participate more readily.

Friendly Fascism raises important questions challenging the viability of democratic institutions in America. Professor Gross' analysis is particularly cogent when he deals with the international aspects of "friendly fascism." Extended corporate influence in third world countries, aided by America's foreign policy apparatus, bears a disturbing resemblance to the corporate-state partnership which characterized classical fascist regimes. Gross argues that increasing centralization of corporate power will ultimately bring such repression to America itself. When discussing the domestic aspects of "friendly fascism," however, Professor Gross' analysis is vague and imprecise. The essence of his argument is that America is moving toward a dangerous partnership of big government and big business that works to centralize power and subvert liberty. But *Friendly Fascism*

never focuses on the mechanics of this emerging relationship. While the book promises a comprehensive analysis of the new American power structure, it fails to convey a clear understanding of how the "friendly fascist" establishment actually functions.

The most serious flaw in this work, however, is its failure to take into account democratic forces presently at work in America and their relationship to the corporate establishment. While capital and government have undergone increased centralization, so have public interest groups, labor unions, and other forces that articulate working-class demands. The complex interrelationship of all these forces characterizes the decision-making process in Congress as well as in the executive branch. It may be that resource limitations create inherent barriers to the effectiveness of public interest groups, preventing meaningful representation of the poor in the democratic process. Unfortunately, *Friendly Fascism* sheds no light on this question. Professor Gross ignores public interest groups until the very end of the book when he mentions them only briefly. This omission deprives his readers of a more precise understanding of decision-making in contemporary America.

Friendly Fascism raises difficult issues concerning the impact of centralized power on American democratic institutions. Declining voter turnout rates and widespread cynicism concerning government suggest the declining vitality of American democracy. *Friendly Fascism* attempts to explain the factors which underlie America's growing feeling of alienation from its democratic traditions. Its primary contribution may be to stimulate further efforts to draw a more comprehensive picture of the American power structure and the health of our democracy.

Robert P. Haney, Jr.

THE PRESENT DANGER. By *Norman Podhoretz*. New York: Simon and Schuster, 1980. Pp. 101, $7.95.

The essence of Norman Podhoretz's stimulating attempt in *The Present Danger* to awaken America is captured in the subtitle "Do we have the will to reverse the decline in American power?" Podhoretz, editor of *Commentary* magazine, asserts that the Iranian seizure of the United States embassy marked

the end of one period in American history, while the Russian invasion of Afghanistan less than two months later signaled the beginning of another (p. 11). The author uses a powerful collection of essays to question our society's ability to face the increasing danger of "the Finlandization of America, the political and economic subordination of the U.S. to superior Soviet power" (p. 12).

In the first half of the book, Podhoretz links the loss of resolve and clarity in American foreign policy to the abandonment of "containment," the strategy of "adroit and vigilant application of counter-force at a series of constantly shifting geographical and political points" (p. 18) proposed by George Kennan. The author clearly, although rather simplistically, traces America's post-Vietnam retreat from world leadership, through the Nixon Doctrine's reliance on surrogate power, to former President Carter's emphasis on North-South issues in place of the East-West confrontation.

Podhoretz asserts that the "twin pillars of Carter's foreign policy" — the retrenchment of American power and the perception of the Soviet Union as a status quo power — collapsed in the streets of Teheran and Kabul (p. 48). Podhoretz both praises and questions the late-found resolve of the Carter Doctrine, but warns that it "may be too late" if the Soviet Union perceives a "window of opportunity" is presently open (p. 55).

The chief strength of *The Present Danger* is its provocative elucidation of the psychological dimensions of America's retreat from world leadership. In the latter half of the book, Podhoretz argues that although "there is no necessary logical connection among anti-Americanism, isolationism, and the tendency to explain away or even apologize for anything the Soviet Union does," there is a psychological connection (p. 73). The pacifism and self-flagellation associated with the "culture of appeasement" during Carter's presidency may lead American decision-makers, like their British counterparts in the 1930's, to fear that their "own society would refuse or be unable to resist so powerful and self-confident an enemy" (p. 82).

Podhoretz's prescriptions for facing "this implacable challenge" are revivalist in nature. He recognizes the potential strength of the "new nationalism," but believes it will amount to no more than "sporadic outbursts of indignant energy" (p.

101) unless philosophical underpinnings are developed. This rededication to ideals would begin with the long-absent recognition that Communism is a "curse" (p. 92) entailing cultural destruction, abysmal economic performance, and widespread human repression. The end result would be the re-adoption of containment as a more responsible and courageous alternative to "Finlandization" in the "infinitely more dangerous age ahead" (p. 101).

The Present Danger is a well-written and insightful statement of a position which many have unjustly categorized as reactionary and alarmist. Concerned foreign policy observers of all ideological persuasions should find *The Present Danger* a thought-provoking statement on the proper goals for American foreign policy.

William J. Guzick

THE REVERSE DISCRIMINATION CONTROVERSY: A MORAL AND LEGAL ANALYSIS. By *Robert K. Fullinwider*. Totowa, N.J.: Rowman and Littlefield, 1980. Pp. 291, index.

Robert K. Fullinwider's *The Reverse Discrimination Controversy: A Moral and Legal Analysis* attempts to make some sense from the debate over preferential hiring. To a great extent, the book succeeds. It pierces the rhetoric of both camps and clarifies the premises of many of the arguments for and against preferential hiring.

The author, a philosophy professor affiliated with the University of Maryland's Center for Philosophy and Public Policy, writes in a clear, unpretentious style. He never pursues flights of philosophical fancy, and he addresses real problems in a pragmatic, thoughtful manner. The book focuses primarily on the moral justifications for affirmative action, but it also contains insights into cases such as *Bakke* and *Weber* and legislation such as Title VII of the Civil Rights Act of 1964.

Although the author devotes much of the book to a fairly neutral analysis of key issues, he does have a position to defend. He contends that arguments based on "rights" do not provide an adequate justification for preferential hiring; he rests his entire case on "social utility" (p. 90). This position is an odd

one, for most commentators feel that "rights" arguments provide a better rationale for government intervention into the hiring process.

The author's defense of his "social utility" argument is not compelling. It relies upon the belief that "the positive economic effects of the extra blacks employed in higher paying jobs would likely be greater than the negative effect of white losses" (p. 69). This assumption prevents the author from facing hard realities. For the most part, hiring decisions are "zero-sum" choices; social utility, if it is understood primarily in economic terms, does not provide an argument for affirmative action. In fact, in the short run affirmative action probably diminishes overall utility because it channels more resources into training and recruitment, an effect which the author seems to acknowledge in his discussion of efficiency (pp. 86-90). Thus, to discount "rights" arguments is to deny that any basis for affirmative action exists.

Despite the problems with the author's main argument, *The Reverse Discrimination Controversy* is non-polemical and challenging. One need not accept the author's viewpoint to benefit from his analysis of a difficult public policy problem.

Michael J. Astrue

WHISTLE-BLOWING! LOYALTY AND DISSENT IN THE CORPORATION. By *Alan F. Westin*, ed., with *Henry I. Kurtz* and *Albert Robbins*. New York: McGraw-Hill Book Co., 1981. Pp. x, 167, selected bibliography, index. $12.50.

Ten "whistle-blowing" experiences of corporate employees are presented in this collection of stories edited by Alan F. Westin, Professor of Public Law and Government at Columbia University. *Whistle-Blowing! Loyalty and Dissent in the Corporation* stems from the work of the Educational Fund for Individual Rights — of which Professor Westin is President — a non-profit foundation organized to support research and educational activities concerning individual rights in corporate employment.

The book begins with an introduction by Professor Westin, who describes whistle-blowers as:

> employees who believe their organization is engaged in illegal, dangerous, or unethical conduct. Usually, they try to have such conduct corrected through inside complaint, but if it is not, the employee turns to government authorities or the media and makes the charge public. Usually, whistle blowers get fired. Sometimes, they may be reinstated. Almost always, their experiences are traumatic, and their careers and lives are profoundly affected. (p. 1)

Professor Westin then sketches a brief summary of trends in the law and of social attitudes towards employee rights. This summary provides an excellent historical backdrop against which the experience of each whistle-blower can be more fully understood. The stories themselves come from a broad cross-section of corporate employees, representing a wide spectrum of geographical location and personal background. The occupations represented range from professional to line staff, including those of airline pilot, secretary, engineer, attorney, and advertising salesperson. The complaints are varied as well, concerning, for example, unsafe passenger aircraft, illegal campaign contributions, dangerous nuclear reactors, sexual harrassment, unsafe construction sites, and potentially harmful drugs. Most of the stories are related in first-person narratives; all are dramatically compelling and explicit in naming names and dates.

The stories are told from the perspectives of the individual whistle-blowers; no opportunity is given the corporations involved to answer allegations regarding their handling of the episodes. Both sides of the issue, however, are treated in Professor Westin's conclusion following the ten stories. There he addresses the numerous factors that should be considered in developing new policies that will encourage and protect responsible whistle-blowing while remaining sensitive to the practical needs of corporations. Such factors include the problem of inaccurate charges, incursions upon the autonomy of the private sector, unclear legal definitions of what constitutes a "safe" product, and improper treatment of employees. With these factors in mind, Westin offers suggestions for creating effective whistle-blowing systems within the corporation, as well as for the development of responsive legislative and judicial measures outside the corporation. He also offers guidelines for potential whistle-blowers.

Whistle-Blowing! Loyalty and Dissent in the Corporation is both interesting and readable. The ten dramatic stories focus the reader's attention on the problem of whistle-blowing, and Professor Westin makes constructive use of that attention by offering suggestions for possible means of dealing with it. While the book should reach those directly involved in corporate operations, it should be of interest to anyone. The issues raised in the book go beyond the employer-employee relationship and encompass the larger questions of morality, the balancing of public safety and economics, and the need for legislative and judicial action in response to an important social dilemma.

Margaret Allen-Crawford

BOOKS RECEIVED

ABORTION POLITICS: PRIVATE MORALITY AND PUBLIC POLICY. By *Frederick S. Jaffe, Barbara L. Lindheim* and *Philip R. Lee*. New York: McGraw-Hill Book Company, 1981. Pp. viii, 216, references, index. $14.95.

THE AGE OF SURVEILLANCE: THE AIMS AND METHODS OF AMERICA'S POLITICAL INTELLIGENCE SYSTEM. By *Frank J. Donner*. New York: Alfred A. Knopf, 1980. Pp. 554, appendices, notes, bibliography, index. $17.95.

CONGRESS AND MONEY: BUDGETING, SPENDING, AND TAXING. By *Allen Schick*. Washington, D.C.: The Urban Institute, 1980. Pp. xiii, 604, appendix, index. $27.50.

CONSUMER'S GUIDE TO COSMETICS. By *Tom Conry*. New York: Doubleday and Company, 1980. Pp. 376, appendix, notes, index. $3.95 paper.

THE DEFENSE INDUSTRY. By *Jacques S. Gansler*. Cambridge, Ma.: The MIT Press, 1980. Pp. 346, notes, index. $19.95.

DIPLOMACY OF POWER. By *Stephen S. Kaplan*. Washington, D.C.: The Brookings Institution, 1981. Pp. xvi, 733, appendices, index. $29.95 cloth, $14.95 paper.

THE FUTILITY OF FAMILY POLICY. By *Gilbert Y. Steiner*. Washington, D.C.: The Brookings Institution, 1981. Pp. viii, 221, index. $15.95 cloth, $5.95 paper.

GETTING STARTED: THE YOUTH LABOR MARKET. By *Paul Osterman*. Cambridge, Ma.: The MIT Press, 1980. Pp. 197, appendices, notes, index. $20.00.

HEALTH POLICY: THE LEGISLATIVE AGENDA. Washington, D.C.: Congressional Quarterly, 1980. Pp. 140, appendix.

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