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ARTICLE

JUDICIAL IMMUNITY FOR WHITE-COLLAR CRIME: THE IRONIC DEMISE OF CIVIL RICO

MICHAEL GOLDSMITH*

The application of the Racketeer Influenced and Corrupt Organizations Law ("RICO") to white-collar crime has generated much controversy. In this Article, Professor Goldsmith argues that judicially imposed limitations have created virtual immunity for white-collar crime under RICO. The author reviews RICO interpretive guidelines developed by the Supreme Court, how the lower federal courts have disregarded these guidelines and restrictively rewritten RICO, and the adverse consequences for civil and criminal cases. He concludes with a call for corrective countermeasures—a return to integrity in statutory construction or congressional revitalization of RICO.

In 1970, Congress enacted the Racketeer Influenced and Corrupt Organizations law ("RICO").[1] By providing new criminal and civil sanctions, RICO sought to attack the foundations of organized crime.[2] Congress chose to draft this law broadly. Thus, the terms of RICO expressly reach beyond traditional organized crime to include certain aggravated white-collar criminality.[3]

Initially, however, federal prosecutors used RICO principally against traditional organized crime. Consequently, the legal community at first failed to recognize that RICO also applies to

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* Professor of Law, Brigham Young University. B.A., 1972, J.D., Cornell University, 1975. The author, a former Assistant United States Attorney and Counsel to the New York State Organized Crime Task Force, has testified on RICO and other matters before the Congress. He is currently Vice-Chairperson of the RICO Cases Committee, American Bar Association, Criminal Justice Section. The author wishes to express his appreciation to Darin Judd, David Golden, and Jeff Buhman for providing research assistance. In addition, BYU reference librarians Karen Newmeyer and Kory Staheli provided their usual fine support. Ms. Newmeyer, in particular, conducted an extraordinarily laborious and thorough statistical survey of reported RICO decisions.

[1] Organized Crime Control Act of 1970, Pub. L. No. 91-452, 84 Stat. 922 (1970) (codified at 18 U.S.C. §§ 1961–1968 (1982 & Supp. III 1985)).

[2] Congress enacted RICO as part of the Organized Crime Control Act of 1970. 84 Stat. 922 (1970). In pertinent part, the accompanying Statement of Findings and Purpose declared that the Act sought "the eradication of organized crime in the United States by strengthening the legal tools in the evidence-gathering process, by establishing new penal prohibitions, and by providing enhanced sanctions and new remedies to deal with the unlawful activities of those engaged in organized crime." *Id.* at 923; *see also* United States v. Turkette, 452 U.S. 576, 589 (1981) (setting forth this aspect of RICO's legislative history).

[3] *See infra* notes 26–32 and accompanying text.

white-collar crime. This realization slowly began to occur in the mid-1970s, when corrupt politicians were first prosecuted under RICO.[4] But the realization only became fully pronounced in the 1980s, when victims of white-collar fraud suddenly began to sue under RICO's civil remedy provision.[5] RICO section 1964(c), which authorizes treble damages and counsel fees,[6] became the most powerful legal weapon available to combat commercial fraud.[7]

Although white-collar crime costs society more than $200 billion annually,[8] civil RICO soon met widespread judicial hostility.[9] The clarity of RICO's textual application to white-collar crime made no difference to many federal judges, who viewed the statute as an organized-crime measure run amok.

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[4] *See, e.g.*, United States v. Frumento, 563 F.2d 1083, 1090–91 (3d Cir. 1977) (targeting member of state agency), *cert. denied*, 434 U.S. 1072 (1978); United States v. Mandel, 415 F. Supp. 997, 1018–19 (D. Md. 1976) (targeting governor of Maryland), *aff'd*, 591 F.2d 1347 (4th Cir.), *aff'd on reh'g*, 602 F.2d 653 (4th Cir. 1979) (en banc), *cert. denied*, 445 U.S. 961 (1980). Eventually, the Department of Justice prosecuted the notorious ABSCAM defendants under RICO. *See* United States v. Jannotti, 729 F.2d 213, 217 (3d Cir. 1984); United States v. Walsh, 700 F.2d 846, 851 (2d Cir. 1983).

[5] In 1985, the Supreme Court observed: "Of 270 District Court [civil] RICO decisions prior to this year, only 3% (nine cases) were decided throughout the 1970's, 2% were decided in 1980, 7% in 1981, 13% in 1982, 33% in 1983, and 43% in 1984." Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 481 n.1 (1985) (citation omitted). Between *Sedima* and October, 1989, approximately 1000 RICO cases were filed annually. G. Robert Blakey & Thomas A. Perry, *An Analysis of the Myths That Bolster Efforts to Rewrite RICO and the Various Proposals for Reform: "Mother of God—Is This the End of RICO?"*, 43 VAND. L. REV. 851, 1018–19 (1990).

[6] This provision states: "Any person injured in his business or property by reason of a violation of section 1962 of this chapter may sue therefore in any appropriate United States district court and shall recover threefold the damages he sustains and the cost of the suit, including a reasonable attorney's fee." 18 U.S.C. § 1964(c) (1988).

[7] Indeed, the American Bar Association sponsored a symposium and published a manual on the subject. ABA DIV. OF PROFESSIONAL EDUC., RICO: THE ULTIMATE WEAPON IN BUSINESS AND COMMERCIAL LITIGATION (1983).

[8] *See, e.g.*, Blakey & Perry, *supra* note 5, at 881–909 (analyzing fraud as a current social problem); Michael Goldsmith, *Civil RICO Reform: The Basis For Compromise*, 71 MINN. L. REV. 827, 833 (1987) (setting forth statistics on fraud in America).

[9] For example, one study shows that in 1985 and 1986 combined, trial courts completely dismissed approximately 50% of all RICO claims, and partially dismissed another 5.9%. G. Robert Blakey & Scott D. Cessar, *Equitable Relief Under Civil RICO: Reflections on* Religious Technology Center v. Wollersheim*: Will Civil RICO Be Effective Only Against White-Collar Crime?*, 62 NOTRE DAME L. REV. 526, 619 (1987). Another study indicates that, from January 1, 1987, through June 1, 1989, trial courts rejected 65% of all RICO claims during the pre-trial stage. *RICO Reform Act of 1989: Hearings on H.R. 1046 Before the Subcomm. on Crime of the House Comm. on the Judiciary*, 101st Cong., 1st Sess. 630 (1989) (statement of Ronald Goldstock, Director of the New York State Organized Crime Task Force). These statistics are especially significant because pre-trial motions to dismiss are rarely granted in other contexts. *See* 5A CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE & PROCEDURE § 1357, at 321–25 (1990). *See generally* Stephen Horn, *Judicial Plague Sweeps U.S.: "Resultorientitis" Infects Civil RICO Decisions*, NAT'L L.J., May 23, 1983, at 13 (criticizing decisions in which RICO was construed narrowly).

Thus, although RICO contains a liberal construction clause directing that "[t]he provisions of this Title shall be liberally construed to effectuate its remedial purposes,"[10] the lower federal courts often apply the law restrictively. As a result, the vast majority of civil RICO claims are routinely dismissed before trial.[11] Moreover, even though Congress designed RICO to operate without technical limitations comparable to those restricting analogous laws,[12] federal judges regularly place their own constraints on RICO.

Today, RICO is laden with such limitations. Ironically, these limitations have been imposed by lower federal courts rather than by the Supreme Court. Indeed, whenever the Supreme Court has considered RICO, the statute has survived intact.[13] Although the Court may not have agreed with RICO politically or philosophically,[14] the justices felt bound by the statutory text. Instead of imposing judicial limitations, the Court signaled that legislative reform might be appropriate.[15]

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[10] 84 Stat. 947 (1970). The Supreme Court has stated that "[s]o far as we have been made aware, this is the only substantive federal criminal statute that contains such a directive." Russello v. United States, 464 U.S. 16, 27 (1983). Moreover, the Court has emphasized that "[t]he statute's 'remedial purposes' are nowhere more evident than in the provision of a private action for those injured by racketeering activity." Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 498 (1985). *See generally* Craig W. Palm, Note, *RICO and the Liberal Construction Clause*, 66 CORNELL L. REV. 167 (1980) (noting Congress's intent for a broad interpretation, and arguing that courts should construe the statute liberally).

[11] A review of 264 RICO cases reported by LEXIS between January and June of 1991 reveals that approximately 77% were rejected before trial. Search of LEXIS, Genfed Library, Newer File (Nov. 30, 1992). Between January and April of 1992, approximately 78% of 152 RICO cases were likewise dismissed. *Id.*; *see also supra* note 9.

[12] For example, Senator John L. McClellan (D-Ark.), principal sponsor of RICO, noted that RICO contained antitrust roots but emphasized that "[t]here is . . . no intention here of importing the great complexity of antitrust law enforcement into this field." 115 CONG. REC. 9567 (1969). Accordingly, the Supreme Court has observed:

> It is also significant that a previous proposal to add RICO-like provisions to the Sherman Act had come to grief in part precisely because it "could create inappropriate and unnecessary obstacles in the way of . . . a private litigant [who] would have to contend with a body of precedent—appropriate in a purely antitrust context—setting strict requirements on questions such as 'standing to sue' and 'proximate cause.'"

Sedima, 473 U.S. at 498 (citations omitted).

[13] *See infra* notes 41–103 and accompanying text.

[14] For example, both Chief Justice Rehnquist and Justice Kennedy have called for reform restricting RICO. *See* Schreiber Distrib. v. Serv-Well Furniture Co., 806 F.2d 1393, 1402 (9th Cir. 1986) (Kennedy, J., concurring); William H. Rehnquist, *Reforming Diversity Jurisdiction and Civil RICO*, 21 ST. MARY'S L.J. 5, 9, 12 (1989).

[15] *See, e.g.*, H.J. Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229, 249 (1989) ("RICO may be a poorly drafted statute; but rewriting it is a job for Congress . . . ."); *Sedima*, 473 U.S. at 499 ("[D]efect—if defect it is—is inherent in the statute as written, and its correction must lie with Congress.").

Congress responded by considering numerous proposed reforms.[16] None of these measures, however, became law, and the absence of legislative reform, together with the Supreme Court's reluctance to curtail RICO unilaterally, created a legal context seemingly conducive to civil RICO litigation. RICO, however, never prospered. In place of legislative action—and despite Supreme Court guidelines to the contrary—the lower federal courts imposed their own brand of reform. As a consequence, civil RICO is now on the verge of extinction. White-collar crime may soon be outside the statute's reach, and ironically, traditional organized-crime prosecutions may likewise be jeopardized.

This Article seeks to demonstrate how and why judicially imposed limitations have created virtual immunity for white-collar crime under RICO. Section I explains the nature and function of RICO. Section II reviews RICO interpretative guidelines as developed by the Supreme Court. Section III details how the courts have ignored these guidelines by rewriting RICO restrictively, and explores the adverse consequences for civil and criminal cases. Finally, Section IV calls for integrity in statutory construction, and proposes corrective reform to maintain the proper scope of RICO.

I. The Nature and Function of RICO

Congress enacted RICO after two decades of study established the need for a systematic attack on organized crime.[17] In 1951, the historic hearings conducted by Senator Estes Kefauver (D-Tenn.) demonstrated that existing sanctions had failed to prevent organized crime from infiltrating legitimate businesses.[18] The Kefauver hearings later inspired Senator John L. McClellan

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[16] *See* Goldsmith, *supra* note 8, at 884–911 (setting forth various proposals that did not become law); William J. Hughes, *RICO Reform: How Much Is Needed?*, 43 VAND. L. REV. 639, 639–46 (1990) (reviewing status of reform proposals).

[17] *See* G. Robert Blakey, *The Civil RICO Fraud Action in Context: Reflections on* Bennett v. Berg, 58 NOTRE DAME L. REV. 237, 249–80 (1982) (analyzing legislative history).

[18] The Kefauver Committee observed that "[o]ne of the most perplexing problems in the field of organized crime is presented by the fact that criminals and racketeers are using the profits of organized crime to buy up and operate legitimate business enterprises." S. REP. No. 141, 82d Cong., 1st Sess. 33 (1951); *see also* SENATE SPECIAL COMM. TO INVESTIGATE ORGANIZED CRIME IN INTERSTATE COMMERCE, S. REP. No. 725, 82d Cong., 1st Sess. (1951).

(D-Ark.) to investigate organized crime's influence in labor unions and other commercial sectors.[19] These studies, along with work produced by other governmental bodies, eventually led to the enactment of RICO.[20]

The core of RICO is the concept of enterprise.[21] In essence, the statute outlaws every manner in which an enterprise can be used to promote long-term racketeering activity. For example, section 1962(a) outlaws the investment of racketeering proceeds to acquire any interest in an enterprise.[22] This provision reflects the drafters' original concern with the infiltration of legitimate businesses by organized crime.[23] Section 1962(b) expands this concept by prohibiting the acquisition or maintenance of an interest in an enterprise through a pattern of racketeering activity.[24] Finally, section 1962(c) attacks potential violators directly by making it illegal for any person associated with or employed

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[19] *See generally* SENATE SELECT COMM. ON IMPROPER ACTIVITIES IN THE LABOR OR MANAGEMENT FIELD, S. REP. No. 1784, 87th Cong., 2d Sess. (1962); SUBCOMM. ON INVESTIGATIONS OF THE SENATE COMM. ON GOV. OPERATIONS, GAMBLING AND ORGANIZED CRIME, S. REP. No. 1310, 87th Cong., 2d Sess. (1962); S. REP. No. 621, 86th Cong., 2d Sess. (1960); S. REP. No. 1417, 85th Cong., 2d Sess. (1958).

[20] *See* Michael Goldsmith, *RICO and Enterprise Criminality: A Response to Gerard E. Lynch*, 88 COLUM. L. REV. 774, 776–86 (1988) (reviewing pertinent legislative history); *see also* PRESIDENT'S COMM'N ON LAW ENFORCEMENT & ADMIN. OF JUSTICE, THE CHALLENGE OF CRIME IN A FREE SOCIETY 190 (1967); NAT'L COMM'N ON REFORM OF FED. CRIMINAL LAWS, STUDY DRAFT OF A NEW FEDERAL CRIMINAL CODE § 1005 (1970) (proposing the outlawing of "organized crime leadership").

[21] The Seventh Circuit has observed: "The central role of the concept of enterprise under RICO cannot be overstated. It is precisely the criminal infiltration and manipulation of organizational structures that created the problems which led to the passage of RICO." United States v. Neapolitan, 791 F.2d 489, 500 (7th Cir.), *cert. denied*, 479 U.S. 939 (1986); *see also* Thomas S. O'Neill, Note, *Functions of the Enterprise Concept*, 64 NOTRE DAME L. REV. 646, 649–50 (1989) ("[T]he enterprise concept is at the heart of the statute.").

[22] In pertinent part, this provision states:

> It shall be unlawful for any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity or through collection of an unlawful debt in which such person has participated as a principal within the meaning of section 2, title 18, United States Code, to use or invest, directly or indirectly, any part of such income, or the proceeds of such income, in acquisition of any interest in, or the establishment or operation of, any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce . . . .

18 U.S.C. § 1962(a).

[23] *See* Gerard E. Lynch, *RICO: The Crime of Being a Criminal*, 87 COLUM. L. REV. 661, 666–82, 689–92, 701 (1987) (reviewing origins of § 1962(a) and (b), and discussing their intended applications).

[24] This prohibition states: "It shall be unlawful for any person through a pattern of racketeering activity or through collection of an unlawful debt to acquire or maintain, directly or indirectly, any interest in or control of any enterprise which is engaged in, or the activities of which affect, interstate or foreign commerce." 18 U.S.C. § 1962(b).

by an enterprise to conduct that enterprise's affairs through a pattern of racketeering activity.[25]

Congress defined enterprise and other RICO elements broadly. For both constitutional and tactical reasons, these definitions did *not* limit RICO to traditional organized crime.[26] Thus, the statutory definition of "enterprise" includes both illicit groups and illicit entities.[27] Similarly, the definition of "person" reaches both natural persons and white-collar institutions.[28] Finally, the term "racketeering activity" includes a variety of illegal acts traditionally associated with white-collar crime.[29]

Significantly, Congress adopted these definitions in the face of criticism that they would extend RICO's reach beyond illicit groups such as the Mafia.[30] By legislating in this manner, Congress sought to attack "enterprise criminality" rather than any particular group of criminals. Thus, the principal drafter of RICO has observed that: "As finally enacted, RICO authorized the imposition of enhanced criminal penalties and new civil sanctions . . . for all types of organized criminal behavior, that is *enterprise criminality*—from simple political corruption to

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[25] This prohibition states:

> It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt.

Id. § 1962(c).

[26] *See* Goldsmith, *supra* note 20, at 776–78. Thus, as I have stated in a different context:

> The original debates surrounding this law addressed a concern that survives to this day: the question of statutory breadth. Legislators opposed to RICO argued that the statute's reach inappropriately extended beyond traditional organized crime. RICO sponsors, however, responded that the law would be objectionable if limited to a certain type of defendant. Moreover, though traditional organized crime provided the initial catalyst for . . . RICO, its sponsors stressed the need to craft a statute capable of reaching other forms of crime as well. These views ultimately prevailed, as both houses of Congress enacted RICO by substantial majorities.

Michael Goldsmith, *RICO and "Pattern": The Search for "Continuity Plus Relationship"*, 73 CORNELL L. REV. 971, 976–77 (1988) (footnotes omitted); *see also* H.J. Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229, 244–48 (1989) (citing legislative history indicating intent to reach beyond organized crime).

[27] RICO provides that "'enterprise' includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity." 18 U.S.C. § 1961(4).

[28] RICO provides that "'person' includes any individual or entity capable of holding a legal or beneficial interest in property." *Id.* § 1961(3). The United States Code generally defines person to include corporations and other legal entities. 1 U.S.C. § 1 (1988).

[29] 18 U.S.C. § 1961(1) (including mail fraud, wire fraud, bankruptcy fraud, and securities fraud).

[30] *See supra* note 27.

sophisticated white-collar schemes to traditional Mafia-type endeavors."[31] Extensive legislative history supports this view of RICO.[32]

Of further import is that Congress did not settle merely for a new criminal statute with enhanced fines and prison terms. The law also provided for forfeiture of racketeering proceeds and of any enterprise interest that the offender used to violate RICO.[33] Through such criminal forfeitures, Congress hoped to remove the economic incentive for racketeering activity.[34]

In the context of criminal litigation, these sanctions have worked. RICO has become the mainstay of the Justice Department's efforts against organized crime and systemic white-collar wrongdoing.[35] The past decade has witnessed unprecedented success in both convicting sophisticated criminals and forcing forfeiture of their assets.[36]

Congress, however, did not confine RICO to criminal prosecutions. At the behest of the American Bar Association (the "ABA"), Congress incorporated a civil remedy authorizing treble damages plus reasonable counsel fees for racketeering victims.[37] Based in part on the antitrust model, civil RICO sought

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[31] G. Robert Blakey & Brian Gettings, *Racketeer Influenced and Corrupt Organizations (RICO): Basic Concepts—Criminal and Civil Remedies*, 53 TEMP. L.Q. 1009, 1013–14 (1980); *cf.* United States v. Cauble, 706 F.2d 1322, 1330 (5th Cir. 1983) (using the term "enterprise criminality" in a RICO context), *cert. denied*, 465 U.S. 1005 (1984).

[32] Thus, "[e]nterprise criminality should not be read as synonymous with 'organized crime.'" O'Neill, *supra* note 21, at 649 n.12 (citing legislative history); *see also supra* note 26.

[33] 18 U.S.C. § 1963(a)(1).

[34] In discussing the scope of RICO's forfeiture provision, the Supreme Court cited the following statement from the legislative history:

> What is needed here . . . are new approaches that will deal not only with individuals, but also with the economic base through which those individuals constitute such a serious threat to the economic well-being of the Nation. In short, an attack must be made on their source of economic power itself, and the attack must take place on all available fronts.

Russello v. United States, 464 U.S. 16, 27 (1983) (citing S. REP. No. 617, 91st Cong., 1st Sess. 79 (1969)). Accordingly, the Court concluded that "Congress could not have hoped successfully to attack organized crime's economic roots without reaching racketeering profits." *Id.* at 28.

[35] "RICO is the prosecutor's tool of choice in organized crime, political corruption, white-collar crime, terrorism, and neo-Nazi and anti-Semitic hate group prosecutions." Blakey & Perry, *supra* note 5, at 855; *see also* Edward S. G. Dennis, Jr., *Current RICO Policies of the Department of Justice*, 43 VAND. L. REV. 651, 652–55, 670–71 (1990) (reviewing Justice Department's application of RICO).

[36] *See, e.g.*, Blakey & Perry, *supra* note 5, at 855 n.12 (summarizing Department of Justice accomplishments).

[37] *Organized Crime Control, Hearings on S. 30 and Related Proposals Before Subcomm. No. 5 of the House Comm. on the Judiciary*, 91st Cong., 1st Sess. 538, 543–44 (1969) [hereinafter *Organized Crime Control Hearings*] (statement of ABA President-elect Edward L. Wright calling for a treble damages civil remedy); *see also supra* note

both to deter violations and to stimulate private enforcement by encouraging an army of private attorneys general to take on complex racketeering claims.[38] Ironically, the successful attainment of this goal, more than anything else, may have ultimately caused the demise of RICO: civil enforcement efforts seemed only to result in restrictive judicial decisions.

Given RICO's powerful criminal and civil sanctions, virtually all defendants—including both mobsters and white-collar offenders—initially argued that RICO did not apply to their activities.[39] Although such arguments succeeded in some lower courts, they ultimately failed before the Supreme Court. In a series of important decisions, the Supreme Court both refuted these arguments and established interpretive guidelines for determining the proper scope of RICO.[40] Although the lower courts have often ignored these guidelines, the Supreme Court's approach provides the initial framework for proper analysis.

II. Supreme Court RICO Jurisprudence

The Supreme Court has considered eight cases requiring the interpretation of RICO.[41] Five of these cases involved the stat-

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6 (containing text of civil remedy). Senator McClellan characterized the proposed ABA amendments as "constructive contributions." 116 CONG. REC. 25,190 (1970). Previous versions of the proposed law had contained a treble damages remedy. S. 1623, 91st Cong., 1st Sess. § 4(a) (1969); S. 2048–2049, 90th Cong., 1st Sess. (1967).

[38] Upon proposing the treble damages remedy, ABA President-elect Edward L. Wright noted that the amendment was "based upon the concept of Section 4 of the Clayton Act." *Organized Crime Control Hearings*, *supra* note 37, at 543–44. Rep. Emanuel Celler (D-N.Y.), then Chairman of the House Judiciary Committee, also observed that RICO civil remedies are "modeled on those found in the antitrust field." 116 CONG. REC. 35,196 (1970); *cf.* Sedima, S.P.R.L. v. Imrex, Co., 473 U.S. 479, 493 (1985) ("Private attorney general provisions such as § 1964(c) are in part designed to fill prosecutorial gaps . . . . [There is a] need for treble damages as an incentive . . . .") (citations omitted).

[39] "For example, white collar defendants argued that RICO reached only traditional organized crime, while some organized crime defendants maintained that RICO applied *only* to legitimate businesses." Goldsmith, *supra* note 26, at 977 (citations omitted); *see also* Blakey & Gettings, *supra* note 31, at 1012 (noting that RICO became "a favorite target of complaints voiced in the press by defense attorneys," and citing examples of white-collar and organized-crime cases).

[40] *See infra* notes 43–103 and accompanying text.

[41] Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311 (1992) (standing limitations); Tafflin v. Levitt, 493 U.S. 455 (1990) (state court jurisdiction); H.J. Inc. v. Northwestern Bell Tel. Co., 492 U.S. 229 (1989) (pattern element); Agency Holding Corp. v. Malley-Duff & Assocs., 483 U.S. 143 (1987) (limitations period); Shearson/American Express, Inc. v. McMahon, 482 U.S. 220 (1987) (arbitrability of RICO claims); *Sedima*, 473 U.S. 479 (standing limitations); Russello v. United States, 464 U.S. 16 (1983) (scope of forfeiture); United States v. Turkette, 452 U.S. 576 (1981) (scope of enterprise element); *see also* Fort Wayne Books, Inc. v. Indiana, 489 U.S. 46 (1989) (sustaining constitutionality of state RICO law).

ute's scope.[42] In each of these five cases, the Court declined to interpret RICO restrictively.

For example, in its first RICO decision, the Court rejected a novel effort to restrict the meaning of the enterprise element. *United States v. Turkette*[43] raised the question of whether a group formed for *purely illicit* purposes qualified as a RICO enterprise. Since most traditional organized-crime families engage almost exclusively in illicit activities, the proposition that RICO excludes such groups from its definition of enterprise appeared absurd on its face.[44] Nevertheless, the First Circuit ruled that only legitimate entities may constitute RICO enterprises.[45]

In reversing, the Supreme Court emphasized traditional principles of statutory interpretation. Thus, the Court stated: "In determining the scope of a statute, we look first to its language. If the statutory language is unambiguous, in the absence of a

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[42] Four of these cases are discussed *infra* notes 43–103 and accompanying text. The fifth case, *Holmes v. Securities Investor Protection Corp.*, concerned the question of whether purchaser/seller standing requirements under the Securities Exchange Act of 1934 also apply under RICO. *See Holmes*, 112 S. Ct. 1311. Instead of resolving that question, however, the Court decided *Holmes* by concluding that RICO is governed by a proximate cause requirement. *Id.* at 1316–19. Since the statutory text does not suggest that a proximate cause requirement be excluded, the Court's conclusion in *Holmes* did not impose a new or inappropriate judicial limitation on RICO. It merely reflected previously established jurisprudence.

The Supreme Court's other RICO decisions involved questions of jurisdiction, the limitations period, and the arbitrability of RICO claims. *See supra* note 41. None of these issues turned on the language of RICO.

[43] 452 U.S. 576 (1981).

[44] *See supra* notes 1–2. Thus, during oral argument before the Supreme Court, counsel for the appellee had difficulty denying the plain meaning of the statute's title:

> Mr. Wall: RICO was an integrated statute in itself, part of an integrated whole, the Organized Crime Act. True the Organized Crime Act was designed to eradicate organized crime.
>
> . . . .
>
> Question: Let's suppose that if some group, . . . 21 people, set up a specialty of collecting illegal debts. That is, usurious debts, gambling debts, . . . and that's all they do. *You say they are not covered*?
>
> Mr. Wall: I say they are not covered.
>
> Question: You mean they can't be prosecuted under this statute? . . . Isn't this one of the broadest nets that Congress has ever thrown out to catch criminal activity?
>
> Mr. Wall: It is probably—well, I suggest, it may—it is, the Organized Crime Control Act is a very broad net.

Appellee's Oral Argument at 26, 28, United States v. Turkette, 452 U.S. 576 (1981) (No. 80-808) (emphasis added).

[45] United States v. Turkette, 632 F.2d 896 (1st Cir. 1980), *rev'd*, 452 U.S. 576 (1981).

'clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive.'"[46]

Given this standard, Justice White in his majority opinion reasoned that the statutory definition of enterprise plainly includes both licit and illicit organizations.[47] He observed that the First Circuit had "clearly departed from and limited the statutory language."[48] In particular, the First Circuit had applied a principle of statutory construction that properly "comes into play only when there is some uncertainty as to the meaning of a particular clause in a statute."[49] Since no uncertainty existed about the meaning of enterprise, nothing justified narrowing its meaning through interpretive aids designed for other situations.[50]

Although RICO's plain text and title[51] make clear that the law applies to corrupt organizations, the Supreme Court reinforced its conclusion with traditional tools of statutory analysis.[52] Examining the statutory structure, Justice White noted that his interpretation did not create absurd results or internal anoma-

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[46] *Turkette*, 452 U.S. at 580 (citations omitted). The Court's approach reflects established principles of statutory construction. *See infra* notes 52, 56. *See generally* 2A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 46.01 (5th ed. rev. 1992). Complete analysis, however, requires more than merely reading the statutory text. As the Court further observed, "there is no errorless test for identifying . . . 'plain' or 'unambiguous' language. Also, . . . absurd results are to be avoided and internal inconsistencies in the statute must be dealt with." *Turkette*, 452 U.S. at 580 (citations omitted). Ironically, judicial interpretations of RICO by lower courts have created statutory ambiguities and caused both absurd results and internal inconsistencies. *See infra* notes 107–212 and accompanying text.

[47] *Turkette*, 452 U.S. at 580–81.

[48] *Id.* at 581.

[49] *Id.* The Court also declined to apply the rule of lenity because "[t]hat 'rule,' as is true of any guide to statutory construction, only serves as an aid for resolving an ambiguity; it is not to be used to beget one." *Id.* at 587 n.10 (citations omitted).

[50] *Turkette* is also significant because it foreshadowed the application of RICO to white-collar crime. Justice White observed that "[t]he mere fact that a given enterprise is favored with a legal existence does not prevent that enterprise from proceeding along a wholly illegal course of conduct." *Id.* at 582 n.4.

[51] RICO is an acronym for Racketeer Influenced and Corrupt Organizations. The corrupt organization is the illicit entity, whereas the racketeer influenced enterprise is the entity that has been infiltrated by organized crime. According to Professor Blakey and Mr. Gettings, "[t]he development of the language of the title . . . shows that it reflects precisely this distinction." Blakey & Gettings, *supra* note 31, at 1025 n.91.

[52] The Court examined both the structure and legislative history of the statute. Examining statutory structure is customary as a means of properly understanding the text. *See* 1A NORMAN J. SINGER, SUTHERLAND STATUTORY CONSTRUCTION § 20.01, at 79–80 (4th ed. rev. 1985). Furthermore, although the Supreme Court has suggested that the plain meaning rule precludes resort to legislative history, "[i]n almost all of the leading plain meaning cases of the Warren and Burger [eras] the Court checked the legislative history to be certain that [their] confidence in the clear text did not misread the legislature's intent." William N. Eskridge, Jr., *The New Textualism*, 37 UCLA L. REV. 621, 627 (1990) (citing extensive authority).

lies: "[A]pplying [RICO] to criminal organizations does not render any portion of the statute superfluous nor does it create any structural incongruities within the framework of the Act."[53]

Finally, to refute the argument that bringing illicit groups within RICO improperly injects the federal government into matters traditionally reserved for state law enforcement, the Court turned to legislative history demonstrating "that Congress was well aware that it was entering a new domain of federal involvement through the enactment of this measure."[54] Ultimately, however, the Court principally based its conclusion on the language of RICO:

> If Congress had intended the more circumscribed approach espoused by the Court of Appeals, *there would have been some positive sign* that the law was not to reach organized criminal activities that give rise to the concerns about infiltration. *The language of the statute, however—the most reliable evidence of its intent*—reveals that Congress opted for a far broader definition of the word "enterprise," and we are unconvinced by anything in the legislative history that this definition should be given less than its full effect.[55]

In reaching this outcome, the Court followed generally established principles of statutory construction. It relied principally on statutory text and structure and turned to the legislative history only to ensure that it did not clearly conflict with the Court's analysis.[56]

In *Russello v. United States*,[57] the Court again followed these interpretive principles. *Russello* concerned the question of whether racketeering profits fall within the scope of RICO's

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[53] *Turkette*, 452 U.S. at 587.

[54] *Id.* at 586. Justice White conducted a balanced evaluation of this legislative history. First, he recognized that "the legislative history forcefully supports the view that the major purpose of [RICO] is to address the infiltration of legitimate business by organized crime." *Id.* at 591. However, he also noted ample evidence of legislative intent to attack corrupt organizations directly—*before* their members even attempt to infiltrate legitimate businesses. *Id.* at 591–92.

[55] *Id.* at 593 (emphasis added).

[56] Other Supreme Court decisions have adopted similar methodology. *See, e.g.*, Immigration & Naturalization Serv. v. Cardoza-Fonseca, 480 U.S. 421, 432 n.12 (1987) (citing United States v. James, 478 U.S. 597, 606 (1986)). The Supreme Court, however, has not adopted a single approach to statutory construction. The plain meaning rule, for example, is given different weight by different justices. Some justices accept the plain meaning of a statute but are still willing to consider legislative history in varying degrees. Others, such as Justice Scalia, generally refuse to consider legislative history in virtually any respect. *See* Eskridge, *supra* note 52, at 623. Nevertheless, with respect to RICO the Supreme Court has consistenty taken the approach outlined in the text. Thus, the lower courts have no basis for deviating from this path.

[57] 464 U.S. 16 (1983).

forfeiture provision. On its face, the law seemed relatively clear: RICO provides that an offender shall forfeit to the United States "any interest he has acquired or maintained in violation of [the law]."[58] Ordinarily, the term "interest" includes the concept of profit.[59] Nevertheless, the circuit courts divided over this question.[60]

In resolving this matter, the Supreme Court's analysis paralled its approach in *Turkette*. Thus, looking first to the statutory text, the Court "start[ed] with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used."[61] On this basis, Justice Blackmun concluded for a unanimous court that the ordinary meaning of the term "'interest' comprehends all forms of real and personal property, including profits and proceeds."[62] Significantly, Justice Blackmun declined to interpret the term "interest" narrowly, reasoning that "Congress selected this general term apparently because it was fully consistent with the pattern of the RICO statute in utilizing terms and concepts of breadth."[63]

Next, the Court again examined the structure of the statute and found that RICO contemplated two types of forfeiture: loss of an interest "*in* the enterprise" and loss of profits.[64] Thus, the Court's analysis did not render any part of RICO redundant.[65]

Given this analysis, the Court intimated that resort to legislative history was unnecessary.[66] Justice Blackmun, nonetheless, observed that the legislative history supported the conclusion that "interest" encompasses profits.[67] Thus, the Supreme Court declined to narrow the scope of RICO forfeiture.[68]

In short, both *Turkette* and *Russello* sustained the broad application of RICO. These decisions, however, involved RICO *criminal* prosecutions. Broad application in a civil context posed

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[58] 18 U.S.C. § 1963(a)(1). Congress subsequently amended § 1963(a) to make explicit that forfeiture extends to "proceeds which the person retained, directly or indirectly from racketeering." Comprehensive Crime Control Act of 1984, Pub. L. No. 98-473, § 302, 98 Stat. 2040, 2192 (codified as amended at 18 U.S.C. § 1963(a) (1988)). Thus, Congress codified the Supreme Court holding in *Russello*.

[59] *Russello*, 464 U.S. at 21 (citing common dictionary definition).

[60] *Id.* at 18.

[61] *Id.* at 21 (quoting Richards v. United States, 369 U.S. 1, 9 (1962)).

[62] *Id.*

[63] *Id.*

[64] *Id.* at 22.

[65] *Id.* at 24.

[66] *Id.* at 26.

[67] *Id.* at 26–28.

[68] *Id.* at 27–28.

new and more complex issues, such as the desirability of commercial fraud litigation involving some of society's most respected businesses.[69] Nevertheless, in *Sedima, S.P.R.L. v. Imrex Co.*,[70] the Supreme Court recognized that RICO also applies to white-collar institutions.

Sedima set aside two judicially imposed limitations on civil RICO. In an effort to curtail the application of RICO to routine business disputes based on so-called "garden variety" fraud, the Second Circuit had ruled that civil RICO suits required both a prior criminal conviction and proof of a special "racketeering injury."[71] The Supreme Court rejected both of these requirements by applying the same analysis used in *Turkette* and *Russello*.

Turning first to the Second Circuit's prior conviction requirement, the Court looked to the statutory text and observed that "[t]he word 'conviction' does not appear in any relevant portion of the statute."[72] Furthermore, Justice White's majority opinion observed that "if either § 1961 or § 1962 did contain such a provision, a prior conviction would also be a prerequisite, nonsensically, for a *criminal* prosecution" as well as a civil action filed by the Government.[73] Finally, the Court stressed that the legislative history did not support a prior-conviction doctrine, and that, if anything, such a requirement ran counter to the policy considerations underlying a treble damages provision.[74] On this basis, Justice White criticized the Second Circuit for having "invent[ed] . . . a requirement that cannot be found in the statute and that Congress, as even the Court of Appeals had to concede, . . . did not envision."[75]

The Court similarly rejected the Second Circuit's racketeering injury requirement. Using an analogy to antitrust doctrine, the Second Circuit had ruled that "a RICO plaintiff must allege a 'racketeering injury'—an injury 'different in kind from that oc-

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[69] For example, in 1984 the Second Circuit Court of Appeals noted that civil RICO had been used against respected businesses such as E.F. Hutton. Sedima, S.P.R.L. v. Imrex Co., 741 F.2d 482, 487 (2d Cir. 1984), *rev'd*, 473 U.S. 479 (1985). Shortly afterwards, E.F. Hutton pleaded guilty to 2000 counts of mail and wire fraud. Tom Ferris & Andrew Albert, *Bechler to Head Key Post in Hutton Treasury Department*, AM. BANKER, June 19, 1985, at 16.

[70] 473 U.S. 479 (1985).

[71] *Sedima*, 741 F.2d at 487, 494–99.

[72] *Sedima*, 473 U.S. at 488.

[73] *Id.* (emphasis added).

[74] *Id.* at 488–93.

[75] *Id.* at 491 (citation omitted).

curring as a result of the predicate acts themselves, or not simply caused by the predicate acts, but also caused by an activity which RICO was designed to deter.'"[76] Unfortunately, no one knew quite what this meant.[77]

The Supreme Court again resolved the issue by first examining the statutory text and finding no support for such a requirement.[78] The Court emphasized both the liberal construction clause and the "self-consciously expansive language" employed by Congress in creating the RICO remedy: "The statute's 'remedial purposes' are nowhere more evident than in the provision of a private action for those injured by racketeering activity. Far from effectuating these purposes, the narrow readings offered by . . . the court below would in effect eliminate [the civil remedy] from the statute."[79]

Next, the Court returned to legislative history, which supported a broad civil remedy unburdened by various judicially imposed limitations.[80] Thus, based on the statutory text and the supporting legislative history, Justice White declined to read a racketeering injury requirement into the statute.

The Court in *Sedima* acknowledged both that its ruling would bring white-collar offenders within the scope of RICO and that aspects of the statute might be unduly broad.[81] Neither of these factors, however, warranted judicial revision of a legislative enactment:

> Underlying the Court of Appeals' holding was its distress at the "extraordinary, if not outrageous," uses to which civil RICO has been put. Instead of being used against mobsters and organized criminals, it has become a tool for everyday fraud cases brought against "respected and legitimate 'enterprises.'" *Yet Congress wanted to reach both "legitimate" and "illegitimate" enterprises. The former enjoy neither an inherent incapacity for criminal activity nor immunity from its consequences . . . .*
>
> It is true that private civil actions under the statute are being brought almost solely against such [white-collar] defendants, rather than against the archetypal, intimidating

[76] *Id.* at 485 (citation omitted).

[77] The Supreme Court characterized "racketeering injury" as an "amorphous" term. *Id.* at 495. Accordingly, Justice White wrote that "[t]he court below is not alone in struggling to define 'racketeering injury,' and the difficulty of that task itself cautions against imposing such a requirement." *Id.* at 494.

[78] *Id.* at 495.

[79] *Id.* at 498 (citations omitted).

[80] *Id.* at 498–99.

[81] *Id.* at 499–500.

> mobster. Yet this defect—if defect it is—is inherent in the statute as written, and its correction must lie with Congress.[82]

Finally, although Justice White declined to rewrite the statute, he intimated that its breadth could be curtailed by developing a more "meaningful concept of 'pattern.'"[83] The statutory standard for pattern merely imposed a minimal requirement of two racketeering activities within ten years of each other.[84] Citing legislative history, Justice White suggested that two predicate acts generally are not enough to form a pattern.[85] Two such acts, in other words, afforded a necessary *but not always sufficient* condition for proof of pattern. The legislative record stated that, taken together, the predicate acts must also establish "'*continuity plus relationship*.'"[86]

Although in pre-*Sedima* cases courts had regularly found a pattern based on two acts of racketeering activity,[87] Justice White's suggestion prompted federal courts to reconsider the issue by resolving the meaning of "continuity plus relationship." In the confusion that followed, some courts adopted a highly restrictive interpretation requiring proof of multiple schemes as a prerequisite to pattern.[88] Under this approach, a single scheme could not qualify as a pattern, notwithstanding its duration, number of victims, or extent of the harm that it produced.[89] The Eighth Circuit's adoption of this standard prompted the Supreme Court to reverse in *H.J. Inc. v. Northwestern Bell Tel. Co.*[90]

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[82] *Id.* at 499 (emphasis added) (citations and footnote omitted).

[83] *Id.* at 500.

[84] In pertinent part, RICO provides that a "'pattern of racketeering activity' requires at least two acts of racketeering activity, one of which occurred after the effective date of this chapter and the last of which occurred within ten years . . . after the commission of a prior act of racketeering activity." 18 U.S.C. § 1961(5).

[85] *Sedima*, 473 U.S. at 496 n.14.

[86] *Id.* (quoting from S. REP. No. 617, 91st Cong., 1st Sess. 158 (1969) (emphasis added)).

[87] *See, e.g.*, United States v. Calabrese, 645 F.2d 1379, 1389 (10th Cir.), *cert. denied*, 454 U.S. 831 (1981); United States v. Weatherspoon, 581 F.2d 595, 602 (7th Cir. 1978); United States v. Parness, 503 F.2d 430, 441–42 (2d Cir. 1974), *cert. denied*, 419 U.S. 1105 (1975).

[88] *See, e.g.*, Goldsmith, *supra* note 26, at 983–84 (citing cases); Ethan M. Posner, Note, *Clarifying a "Pattern" of Confusion: A Multi-Factor Approach to Civil RICO's Pattern Requirement*, 86 MICH. L. REV. 1745, 1754–56 (1988) (same).

[89] *See* Barticheck v. Fidelity Union Bank, 832 F.2d 36, 39 (3d Cir. 1987) (rejecting multiple-scheme test on this basis); Morgan v. Bank of Waukegan, 804 F.2d 970, 975 (7th Cir. 1986) (same). *See generally* Goldsmith, *supra* note 26, at 984–88 (criticizing multiple-scheme test).

[90] 492 U.S. 229 (1989).

In *H.J. Inc.*, the Supreme Court unanimously rejected the multiple-scheme standard as a prerequisite to establishing a pattern of racketeering activity.[91] The Court's analysis again paralleled prior jurisprudence. Thus, Justice Brennan's opinion began with a textual analysis emphasizing RICO's breadth.[92] In addition, he "start[ed] with the assumption that the legislative purpose is expressed by the ordinary meaning of the words used."[93] Considering the "relaxed limits to the pattern concept fixed in § 1961(5)," the Court reasoned "that Congress intended to take a flexible approach" towards this element.[94] Legislative history also provided support for this conclusion.[95]

As the Court noted, neither the language of the statute nor its legislative history mentions the term "scheme."[96] In addition, the Court found the multiple-scheme requirement to be unduly rigid and inconsistent with the flexibility envisaged by Congress.[97] Rather than proof of multiple schemes, the Court held that a pattern requires "continuity of racketeering activity, or its threat, *simpliciter*."[98]

Finally, and perhaps most significantly, *H.J. Inc.* rejected a novel effort by various *amici curiae* to narrow RICO by interpreting the pattern element to require proof that a defendant's activities "are characteristic either of organized crime in the traditional sense, or of an organized-crime-type perpetrator."[99] This limitation found no support either in the statute's text or its legislative history. If anything, a comparison of RICO with other provisions of the Organized Crime Control Act demonstrated that Congress had consciously expanded the text beyond

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[91] *Id.* at 234–35.
[92] *Id.* at 237.
[93] *Id.* at 238 (quoting Richards v. United States, 369 U.S. 1, 9 (1962)).
[94] *Id.*
[95] *Id.* at 239.
[96] *Id.* at 241.
[97] *Id.* at 240–41.
[98] *Id.* at 241. The Court, however, did expand upon this standard:

> "Continuity" is both a closed- and open-ended concept, referring either to a closed period of repeated conduct, or to past conduct that by its nature projects into the future with a threat of repetition. It is . . . centrally a temporal concept . . . . A party alleging a RICO violation may demonstrate continuity over a closed period by proving a series of related predicates extending over a substantial period of time. Predicate acts extending over a few weeks or months and threatening no future criminal conduct do not satisfy this requirement: Congress was concerned in RICO with long-term criminal conduct.

Id. at 241–42 (citations omitted). In addition to "continuity," the Court found that pattern requires proof of some "relationship" involving the predicate acts. *Id.* at 240.
[99] *Id.* at 243–44; *see also* Goldsmith, *supra* note 26, at 989–97 (providing genesis of this argument and grounds for rejecting it).

traditional organized crime.[100] And, although the legislative history emphasized organized crime as a problem, the Court cited substantial portions of the congressional record documenting a legislative concern with a variety of complex criminal problems.[101] Accordingly, Justice Brennan concluded:

> [RICO], with its very generous definition of "racketeering activity," acknowledges the breakdown of the traditional conception of organized crime, and *responds to a new situation in which persons engaged in long term criminal activity often operate wholly within legitimate enterprises.* Congress drafted RICO broadly enough to encompass a wide range of criminal activity, taking many different forms and likely to attract a broad array of perpetrators operating in different ways. It would be counterproductive and a mismeasure of congressional intent now to adopt a narrow construction of the statute's pattern element that would require proof of an organized crime nexus.[102]

Thus, the Court declined to read an organized-crime limitation into RICO. Justice Brennan acknowledged that RICO's approach to combatting criminality may be problematic, but he stressed that "rewriting [the statute] is a job for Congress . . . and not for this Court."[103]

By taking this approach to RICO, the Court acted in accordance with constitutional principles. The plain meaning rule ensures that courts do not exceed their constitutional authority by resort to interpretive devices that undermine the legislative process.[104] Moreover, as the legislative history of most laws may be subject to manipulation and conflicting interpretations,[105] the text and structure of a statute offer a better guide to congressional intent.

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[100] Goldsmith, *supra* note 26, at 993–94.

[101] *H.J. Inc.*, 492 U.S. at 245–47.

[102] *Id.* at 248–49 (emphasis added).

[103] *Id.* at 249.

[104] *See* American Mining Congress v. EPA, 824 F.2d 1177, 1190 (D.C. Cir. 1987); Frank H. Easterbrook, *The Role of Original Intent in Statutory Construction*, 11 HARV. J.L. & PUB. POL'Y 59, 62–63 (1988). *See generally* RICHARD A. POSNER, THE FEDERAL COURTS (1985); Earl M. Maltz, *Statutory Interpretation and Legislative Power: The Case for a Modified Intentionalist Approach*, 63 TUL. L. REV. 1 (1988).

[105] *See* Wallace v. Christensen, 802 F.2d 1539, 1559 (9th Cir. 1986) (Kozinski, J., concurring) ("The fact of the matter is that legislative history can be cited to support almost any proposition, and frequently is."); REED DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 137–97 (1975) (reviewing "The Uses and Abuses of Legislative History"); U.S. DEP'T OF JUSTICE OFFICE OF LEGAL POLICY, USING AND MISUSING LEGISLATIVE HISTORY : A RE-EVALUATION OF LEGISLATIVE HISTORY IN STATUTORY INTERPRETATION (1989).

In any event, the legislative history underlying RICO affords no basis for restrictive judicial limitations.[106] The Supreme Court's decisions establish that RICO is a broadly crafted statute designed to combat enterprise criminality. The law is not limited to traditional organized crime, and the Court's approach to statutory construction demonstrates that RICO ought not to be artificially narrowed by either a crabbed textual interpretation or by unduly rigid readings of the legislative history. Even so, many lower courts have embarked on precisely this course to narrow the scope of civil RICO. The result has been a *de facto* organized-crime limitation on the statute and almost complete immunity under RICO for white-collar enterprises.

III. RICO Reform Through Judicial Revisionism

A. *The Imposition of Extra-Statutory Limitations*

The Supreme Court's RICO decisions predictably generated considerable controversy.[107] Rather than await Congressional action, the lower federal courts developed their own solution: reform through judicial activism. The decisions of the lower courts disregarded Supreme Court directives and reined in the statute by imposing judicial limitations. Those limitations cover a wide range of procedural and substantive grounds.

Procedurally, many courts have precluded RICO litigation by imposing jurisdictional limitations not contemplated by the stat-

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[106] Presumably, Congress enacted a liberal construction clause to avoid this result. *See supra* note 10 and accompanying text; *see also supra* notes 12, 26, 32 and accompanying text.

[107] For example, one commentator recently observed:

> The attention that RICO has garnered in the last few years in the courts, the press, and the legal academy has increased steadily, and the cries for change, at least from some quarters have become deafening. Judge David Sentelle of the D.C. Circuit Court of Appeals recently labeled RICO "The Monster That Ate Jurisprudence;" Chief Justice William Rehnquist has repeatedly called for a defederalization of RICO; and groups as diverse as the *Wall Street Journal*, the *Washington Post*, and the American Civil Liberties Union have argued vociferously for a curtailment of the present statute.

Robert K. Rasmussen, *Introductory Remarks and a Comment on Civil RICO's Remedial Provisions*, 43 VAND. L. REV. 623, 623 (1990) (footnotes omitted).

Ironically, state RICO laws—enacted in 29 jurisdictions—have provoked much less controversy despite text that is often broader than the federal statute. Although a definitive study of state RICO decisions remains to be done, state courts have not always interpreted the statute restrictively. Dover v. State, 385 S.E.2d 417, 419 (Ga. Ct. App. 1989); Computer Concepts, Inc., Profit Sharing Plan v. Brandt, 801 P.2d 800, 807–09 (Or. 1990).

ute. Thus, notwithstanding the legislative suggestion that RICO is intended to supplement other laws generally,[108] federal courts have dismissed RICO claims on the grounds of preemption and abstention.[109] Moreover, even when jurisdiction could be established, the judiciary has often constrained RICO improperly by imposing rigid accrual rules for measuring the statute of limitations,[110] requiring undue specificity in pleadings,[111] rejecting

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[108] *Cf.* Organized Crime Control Act of 1970, Pub. L. No. 91-452, § 904(b), 84 Stat. 922, 947 (supercession clause); United States v. Turkette, 452 U.S. 576, 586 (1981) ("The [Congressional] view was that existing law, state and federal, was not adequate to address the problem, which was of national dimensions."); Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 392 (7th Cir. 1984) ("Congress enacted RICO to supplement, not supplant, the available remedies since it thought those remedies offered too little protection for the victims."), *aff'd*, 473 U.S. 606 (1985). Accordingly, RICO ought not be burdened by standing limitations attendant to those previously existing laws.

[109] For example, upon remand of the decision in *H.J. Inc. v. Northwestern Bell Tel. Co.*, the district court dismissed the case under the "filed rate" doctrine which holds that an administrative rate determination is not subject to judicial review by the federal courts. 734 F. Supp. 879, 882 (D. Minn. 1990), *aff'd*, 954 F.2d 485 (8th Cir. 1992). In addition to ignoring RICO's supplemental purpose, this decision overlooks the fact that such judicial deference makes no sense when plaintiff's claim is that the administrative agency has been corrupted. Congress conceived RICO in a context concerned with political corruption. 84 Stat. at 923 (Statement of Findings and Purpose expressing concern about "corrupt[ion] . . . [of] democratic processes"). Fortunately, not all courts have applied the "filed rate" doctrine to bar RICO litigation. *See* Taffet v. Southern Co., 930 F.2d 847, 856–57 (11th Cir. 1991). Nevertheless, several judges have found RICO preempted on other grounds. *See* Hubbard v. United Airlines, Inc., 927 F.2d 1094, 1098–99 (9th Cir. 1991) (Railway Labor Act); Brennan v. Chestnut, 777 F. Supp. 1469, 1473–75 (D. Minn. 1991), *aff'd*, 973 F.2d 644 (8th Cir. 1992) (National Labor Relations Act); Masters v. Daniel Int'l Corp., No. 87-1290-C, 1991 WL 107410 (D. Kan. May 3, 1991) (Energy Reorganization Act).

[110] RICO is governed by a four-year limitations period drawn from antitrust law. Agency Holding Co. v. Malley-Duff & Assocs., Inc., 483 U.S. 143, 150–56 (1987) (Clayton Act). The critical question is when this time period begins to run. Under federal law an action ordinarily accrues when the plaintiff knows or has reason to know of an injury. *See, e.g.*, Compton v. Ide, 732 F.2d 1429, 1433 (9th Cir. 1984). In RICO cases, this principle poses potential problems because economic injury may occur *before* formation of the pattern. Thus, running the limitations period from the date of initial injury threatens to preclude recovery because the injury may be outside the limitations period by the time that the pattern has been formed. While some courts have responded to this problem by delaying accrual pending formation of the pattern, others have denied recovery for predicates that constitute part of the racketeering pattern but which are outside the four-year period. *See* 15 RICO L. Rep. 174, 174–76 (1992) (collecting cases); Paul B. O'Neill, *"Mother of Mercy, Is This the Beginning of RICO?": The Proper Point of Accrual of a Private Civil RICO Action*, 65 N.Y.U. L. REV. 172, 197–216 (1990).

[111] For example, Rule 9(b) requires that "the circumstances constituting fraud . . . shall be stated with particularity." FED. R. CIV. P. 9(b). Given the potential stigma and enhanced liability associated with a RICO suit, Rule 9(b) provides an important vehicle for ensuring that a claim is factually supported. Michael Goldsmith, *Civil RICO Abuse: The Allegations in Context*, 1986 B.Y.U. L. REV. 55, 87–89; *see also* CHARLES A. WRIGHT & ARTHUR A. MILLER, FEDERAL PRACTICE & PROCEDURE § 1296 (1990). However, in complex cases involving multiple parties and an intricate fraud, it is often unrealistic to expect a victim to plead fraud with particularity. Under such circumstances, courts generally apply Rule 9(b) flexibly, and sometimes even allow discovery to flush out factual detail. *See* 2A JAMES W. MOORE ET AL., MOORE'S FEDERAL PRACTICE

claims for lack of standing,[112] and denying the availability of equitable relief.[113]

The statute has also suffered substantively. For example, some courts have imposed arcane requirements to establish a RICO conspiracy.[114] Likewise, despite the Supreme Court's call for flexibility in *H.J. Inc.*,[115] many judges force absurd results by imposing an overly restrictive standard for what constitutes pattern. Thus, courts have arbitrarily rejected pattern claims on

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§ 9.03[1], at 9-27 to -29 (1992); WRIGHT & MILLER, *supra*, § 1298, at 646–48. In RICO cases, however, the overwhelming trend is to apply the rule strictly to effect dismissal. *See* 16 RICO L. Rep. 1, 79–83 (1992) (index showing disproportionate number of dismissals under Rule 9(b)). *See generally* Cayman Exploration Corp. v. United Gas PipeLine Co., 873 F.2d 1357, 1362 (10th Cir. 1989) (noting range of applications of Rule 9(b)). Although I have previously counseled against undue flexibility in this context, *see* Goldsmith, *supra*, at 88–90, the courts have inappropriately gone to the other extreme. *See* Wabash Valley Power Co. v. Public Service Co., 678 F. Supp. 757 (S.D. Ind. 1988) ("This Court's research reveals that it has become standard practice for RICO defendants to allege lack of specificity. This Court takes a dim view of this allegation strategy because it tends to delay, rather than enhance, resolution of a RICO claim.").

[112] Courts generally deny standing to persons only indirectly injured by racketeering violations. *See, e.g.*, Mid-State Fertilizer v. Exchange Nat'l Bank, 877 F.2d 1333, 1335–36 (7th Cir. 1989) (collecting cases); Bankers Trust Co. v. Rhoades, 859 F.2d 1096, 1100–01 (2d Cir. 1988), *cert. denied*, 490 U.S. 1007 (1989). *See generally* Holmes v. Securities Investor Protection Corp., 112 S. Ct. 1311 (1992) (RICO case drawing analogy from antitrust law where directness of injury "is not the sole requirement" but still a "central element"). Though this principle obviously makes sense, some courts have applied it unfairly. For example, since RICO's statutory history evinces a concern with the corruption of labor unions by organized crime, *see* S. REP. No. 617, 91st Cong., 1st Sess. 78 (1970), union members should not be denied standing to bring RICO claims. However, some courts have done just that. *See* Bass v. Campagnone, 838 F.2d 10, 12–13 (1st Cir. 1988) (holding that union members lack standing because they suffered only indirect injury). If a union has been corrupted, its leadership is unlikely to file a RICO complaint. *See generally* G. Robert Blakey & Ronald Goldstock, *"On the Waterfront": RICO and Labor Racketeering*, 17 AM. CRIM. L. REV. 341 (1980).

[113] *See, e.g.*, In re Fredeman Litig., 843 F.2d 821, 830 (5th Cir. 1988); Religious Tech. Ctr. v. Wollersheim, 796 F.2d 1076, 1084 (9th Cir. 1986), *cert. denied*, 479 U.S. 1103 (1987). The denial of equitable relief to private plaintiffs is often of critical importance because it precludes them from protecting against asset dissipation by defendants. *See* Blakey & Cessar, *supra* note 9, at 554–57 (setting forth statutory analysis and legislative history in support of equitable relief). Absent pre-trial equitable relief, the defendant may become judgment proof.

[114] RICO makes it illegal "for any person to conspire to violate any of the provisions of subsection (a), (b), or (c) of this section." 18 U.S.C. § 1962(d). However, in civil RICO cases, many courts have ruled that the absence of a valid substantive RICO claim under § 1962(a)–(c) automatically precludes the possibility of a surviving conspiracy claim under § 1962(d). *See* Craighead v. E.F. Hutton Co., 899 F.2d 485, 495 (6th Cir. 1990); Condict v. Condict, 826 F.2d 923, 927 (10th Cir. 1987). This automatic preclusion makes no sense. Many reasons potentially account for the failure of a substantive claim. For example, fear of detection may prompt a defendant to discontinue racketeering activity before a pattern forms. Thus, in the criminal context, courts have regularly sustained RICO conspiracy convictions notwithstanding the failure of a substantive count. *See, e.g.*, United States v. Tillie, 729 F.2d 615, 619 (9th Cir.), *cert. denied*, 469 U.S. 845 (1984). As the statutory text draws no distinctions between criminal and civil violations, different rules should not apply in different contexts.

[115] *See supra* notes 94–95 and accompanying text.

the following grounds: (a) the absence of at least a year of racketeering activity;[116] (b) the failure of racketeering activity to constitute a regular part of the defendant's business;[117] (c) the termination of racketeering activity prior to the commencement of suit;[118] (d) the absence of multiple victims;[119] (e) the absence of a pattern *as to each victim* (notwithstanding allegations of multiple victims);[120] (f) the absence of a sufficiently close rela-

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[116] On occasion, it may be appropriate to require at least one year of continuous activity in a RICO case. However, many courts have arbitrarily suggested that one year is an absolute prerequisite. *See, e.g.*, Hughes v. Consol-Pennsylvania Coal Co., 945 F.2d 594, 610–11 (3d Cir. 1991), *cert. denied*, 112 S. Ct. 2300 (1992). In *H.J. Inc.*, the Supreme Court merely stated that "[p]redicate acts extending over a few weeks or months and threatening no future criminal conduct do not satisfy this requirement." 492 U.S. 229, 242 (1989). The Court never suggested anything amounting to an absolute one-year rule. Moreover, Justice Scalia's concurring opinion ridiculed the majority opinion for allowing "a few months of racketeering activity (and who knows how much more?) . . . for free." *Id.* at 254 (Scalia, J., concurring). Nevertheless, the majority of courts now require at least one year. *See, e.g.*, Johnston v. Wilbourn, 760 F. Supp. 578, 588 n.16 (S.D. Miss. 1991) (exhaustively surveying cases and concluding that "[n]o case was found in which predicate acts spanning less than a year, in a closed ended scheme, satisfied the continuity requirement").

[117] In *H.J. Inc.*, the Supreme Court stated that a pattern may be found when "the predicates are a regular way of conducting defendant's ongoing legitimate business." 492 U.S. at 243. Although the Court stressed that this manner of satisfying pattern was illustrative rather than exhaustive, *see id.* at 242, some courts have improperly suggested that regularity is a statutory prerequisite. *See* Gott v. Simpson, 745 F. Supp. 765, 771 (D. Me. 1990).

[118] *See* Thompson v. Paasche, 950 F.2d 306, 311 (6th Cir. 1991); American Eagle Credit Corp. v. Gaskins, 920 F.2d 352, 354–55 (6th Cir. 1990); Mead v. Schaub, 757 F. Supp. 319, 323–24 (S.D.N.Y. 1991). Properly understood, pattern must be examined *at the time of the crime* rather than after the racketeering has ceased. *See* Sun Savings & Loan Ass'n v. Dierdorff, 825 F.2d 187, 194 (9th Cir. 1987); *American Eagle*, 920 F.2d at 355 (Nelson, J., dissenting). Otherwise, pattern would rarely be satisfied, as commencement of litigation usually brings about termination of the illicit conduct.

[119] *See* Menasco, Inc. v. Wasserman, 886 F.2d 681, 684–85 (4th Cir. 1989); R.E. Davis Chem. Corp. v. Nalco Chem. Co., 757 F. Supp. 1499, 1518 (N.D. Ill. 1990) ("A complaint alleging a single scheme and a single victim will normally be found to fall short of establishing a pattern of racketeering activity."). Properly understood, the number of victims is merely a factor to consider in the pattern determination. *See, e.g.*, United States Textiles, Inc. v. Anheuser-Busch Cos., 911 F.2d 1261, 1266–68 (7th Cir. 1990). At the other extreme, even more absurd decisions hold that pattern may *only* consist of predicates involving the plaintiff. *See also infra* note 120.

[120] *See* Religious Tech. Ctr. v. Wollersheim, 971 F.2d 364, 366 n.4 (9th Cir. 1992) (holding that plaintiff lacked "standing to assert the wrongs done to another party"); Landry v. Air Line Pilots Ass'n, 892 F.2d 1238, 1260 (5th Cir. 1990); Yellow Bus Lines, Inc. v. Drivers, Chauffers & Helpers Local Union 639, 839 F.2d 782, 788 (D.C. Cir. 1988) (declining to consider predicates involving other victims), *vacated*, 492 U.S. 914 (1989). Under this reasoning, a perpetrator who injures hundreds or thousands of victims can escape RICO liability if he is careful to injure each victim only once. These decisions fail to distinguish between pattern and injury. A RICO victim may recover damages only for his own injury, but the pattern element goes to the separate question of whether the violator engaged in, or posed a threat of, long term criminal activity. *See* Town of Dearney v. Hudson Meadows Urban Renewal Corp., 829 F.2d 1263, 1268 (3d Cir. 1987) (pattern may include victims other than plaintiff); Marshal & Isley Trust Co. v. Pate, 819 F.2d 806, 809 (7th Cir. 1987). By comparison, plaintiffs suing under civil rights laws

tionship between the predicate acts;[121] and (g) the absence of a "significant societal" injury.[122] Moreover, some courts still reject RICO claims because of the absence of an organized-crime connection or by erroneously asserting that different interpretations apply to civil and criminal RICO.[123]

These judicially imposed limitations have severely hampered the effectiveness of RICO. However, their deleterious effect pales by comparison to a series of decisions that have produced a state of virtual enterprise immunity under RICO.

B. *Enterprise Immunity*

Properly understood, each RICO prohibition addresses a different aspect of enterprise criminality.[124] Depending on the circumstance, the enterprise may serve a variety of functions: (a) beneficiary or prize, (b) instrumentality, (c) victim, or

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routinely rely on other victims to establish a "general pattern of discrimination." *Cf.* McDonnell Douglas Corp. v. Green, 411 U.S. 792, 804–05 (1973).

[121] *See* Vild v. Visconsi, 956 F.2d 560, 566 (6th Cir. 1992). The plaintiff in *Vild* alleged that defendants both defrauded many of their customers and fraudulently induced him to enter into a marketing agreement. The Sixth Circuit rejected the pattern claim because "the two types of conduct have distinct and dissimilar 'purposes, results, participants, victims, or methods of commission.'" *Id.* Careful analysis, however, would have revealed a similarity of such factors. More importantly, the court rejected the previously well-established proposition that the requisite relationship exists among apparently dissimilar predicates if they were committed through a common enterprise. *See* United States v. Weisman, 624 F.2d 1118, 1122 (2d Cir.) (citing other authority), *cert. denied*, 449 U.S. 871 (1980). The *Vild* court argued that this reasoning is limited to organized-crime cases. 956 F. 2d at 568. This view, however, merely reads the discredited organized-crime limitation back into RICO. *See supra* notes 26, 99–102 and accompanying text. Furthermore, numerous *white-collar* RICO decisions have found relationship based on a common enterprise joining diverse predicate acts. *See, e.g.*, *Weisman*, 624 F.2d at 1122 ("The enterprise itself supplies a significant unifying link between the various predicate acts . . . that may constitute a pattern of racketeering activity."); United States v. Lee Stoller Enter., 652 F.2d 1313, 1319 (7th Cir.) ("[The] specific purpose of RICO is to tie together diverse parties and crimes."), *cert. denied*, 454 U.S. 1082 (1981).

[122] Some courts have implied that, even if the technical requirements of RICO are otherwise met, the case may be rejected for lack of a pattern if the defendant's conduct does not pose a "significant societal threat." *See* United States Textiles, 911 F.2d at 1267–68; Marshall-Silver Constr. Co. v. Mendel, 894 F.2d 593, 596–97 (3d Cir. 1990). Although a recent reform proposal contains comparable language, H.R. 1717, 102d Cong., 1st Sess. (1991), it has not yet become law. Nor should such a subjective standard be adopted, since the "significant societal threat" rule would inevitably become a latent organized crime limitation.

[123] *See Vild*, 956 F.2d 560; Michigan v. Fawaz, 8 RICO L. Rep. 120 (1988) (organized-crime limitation by implication).

[124] *See supra* notes 21–25 and accompanying text.

(d) perpetrator of crime.[125] Given this variety of functions, the three substantive RICO prohibitions allow the plaintiff or prosecutor to advance a theory of liability that most accurately reflects the underlying criminality.

For example, under section 1962(a), which prohibits investing racketeering proceeds in an enterprise,[126] the enterprise often may be characterized as a beneficiary of criminality because it received illicit profits.[127] Section 1962(b), which prohibits acquiring an enterprise interest through a pattern of racketeering,[128] usually involves the enterprise as victim.[129] Finally, the enterprise is generally either a perpetrator or instrumentality of crime under section 1962(c),[130] which provides as follows: "It shall be unlawful for any *person* employed by or associated with any *enterprise* engaged in, or the activities of which affect, interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity . . . ."[131] This provision potentially strikes at any enterprise that perpetrates and profits from racketeering. RICO states that "'person' includes any *individual* or *entity* capable of holding a legal or beneficial interest in property."[132] Thus, section 1962(c) reaches both mobsters

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[125] Blakey, *supra* note 17, at 307–24; *see also* Haroco, Inc. v. Amercian Nat'l Bank & Trust Co., 747 F.2d 384, 401 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985) (recognizing these distinctions); O'Neill, *supra* note 21, at 673–77 (showing application of functions in different contexts).

[126] *See supra* note 22.

[127] *See* United States v. McNary, 620 F.2d 621 (7th Cir. 1980) (involving § 1962(a) prosecution with enterprise as beneficiary); O'Neill, *supra* note 21, at 675–76.

[128] *See supra* note 24.

[129] United States v. Local 560, Int'l Bhd. of Teamsters, 780 F.2d 267, 270 (3d Cir. 1985), *cert. denied*, 476 U.S. 1140 (1986) (union as a victim of organized crime takeover); Greyhound Fin. Corp. v. Willyard, No. 87-C-0811B, 1989 U.S. Dist. LEXIS 16040 (D. Utah Dec. 23, 1989).

[130] *See* O'Neill, *supra* note 21, at 674–77. The enterprise acts as a perpetrator when it engages in racketeering activity. *Cf.* United States v. Salerno, 868 F.2d 524, 528–29 (2d Cir.) (mob "commission" as enterprise), *cert. denied*, 491 U.S. 907 (1989); United States v. Yarbrough, 852 F.2d 1522, 1526–28 (9th Cir.) (white supremacist group as enterprise), *cert. denied*, 488 U.S. 866 (1988); United States v. Chang An-Lo, 851 F.2d 547, 550–53 (2d Cir.) (United Bamboo Syndicate as enterprise), *cert. denied*, 488 U.S. 966 (1988). The enterprise acts as an instrumentality when it is used by criminals to promote racketeering activity. *See, e.g.*, United States v. Blackwood, 768 F.2d 131, 134 (7th Cir.) (circuit court enterprise served as instrument to promote bribery), *cert. denied*, 474 U.S. 1020 (1985); United States v. Scotto, 641 F.2d 47, 51, 54 (2d Cir. 1980) (union enterprise served as instrument for extortion of employers), *cert. denied*, 452 U.S. 961 (1981).

[131] 18 U.S.C. § 1962(c) (emphasis added).

[132] *Id.* § 1961(3) (emphasis added).

conducting the affairs of an organized-crime family and entities engaged in white-collar crime.

Although the judiciary has recognized that the enterprise function may vary in different contexts,[133] the courts have not always accommodated their statutory interpretations to this reality. On the contrary, judicial analysis has tended to flout the role of enterprise by protecting perpetrator entities from liability. The genesis of these decisions was the Fourth Circuit's 1982 decision in *United States v. Computer Sciences Corp.*,[134] which established a rule of limitation known as the "person/enterprise distinction."[135] Taken to its extreme, this ill-conceived doctrine threatens to make RICO a historical relic.

1. Origins of the Person/Enterprise Doctrine

In *United States v. Computer Sciences Corp.*, the government filed a multi-count indictment against Computer Sciences Corporation and some of its officers. Two of the counts of the indictment designated a corporate division as the enterprise. A third count named Computer Sciences Corporation as the enterprise. The Fourth Circuit rejected these three counts insofar as they named Computer Sciences Corporation or one of its divisions as an enterprise: "We conclude that 'enterprise' was meant to refer to a being different from, not the same as or part of, the person whose behavior the act was designed to prohibit."[136]

The court imprudently reached this conclusion without carefully analyzing the statutory text. Rather than apply the liberal construction clause of the RICO statute, the Fourth Circuit resorted to the opposite interpretive standard: the rule of "lenity."[137] Applying this principle of narrow construction, *Com-*

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[133] *See, e.g.*, United States v. Porcelli, 865 F.2d 1352, 1362–64 (2d Cir.), *cert. denied*, 493 U.S. 810 (1989); Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 401 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985).

[134] 689 F.2d 1181 (4th Cir. 1982), *cert. denied*, 459 U.S. 1105 (1983).

[135] 15 RICO L. Rep. 256, 292–94 (1992) (collecting cases).

[136] *Computer Sciences*, 689 F.2d at 1190.

[137] *Id.* at 1190–91 (citing United States v. Anderson, 626 F.2d 1358, 1370 (8th Cir. 1980), *cert. denied*, 450 U.S. 912 (1981)). The court also drew an analogy to conspiracy law, reasoning that "we would not take seriously, in the absence, at least, of very explicit statutory language, an assertion that a defendant could conspire with his right arm, which held, aimed and fired the fatal weapon." *Id.* at 1190. This statement, however, overlooked the fact that various corporate employees were also charged with RICO violations. Thus, the indictment did not charge the corporation with acting alone. *Cf.* WAYNE R. LAFAVE & AUSTIN W. SCOTT, JR., CRIMINAL LAW 564 (1986) (suggesting

puter Sciences established the new rule that the person named as a RICO defendant must be distinct from the RICO enterprise.

Although the rule of *Computer Sciences* initially lay somewhat dormant, this concept of a mandatory person/enterprise distinction acquired vitality when civil RICO suits began to proliferate in 1984.[138] At that time, the rule posed a critical obstacle to fraud victims because the perpetrator enterprise was generally the most appropriate—and sometimes the only—"deep pocket" to warrant litigation. Because the perpetrator entity could not be named as both the person/defendant and the RICO enterprise, the financial incentive for litigation disappeared.

Given the hostility of the lower courts to civil RICO during the mid- to late 1980s,[139] virtually every circuit soon adopted the person/enterprise distinction in an effort to curtail civil RICO litigation.[140] The courts offered three justifications for the rule. First, the text of section 1962(c) "clearly envisions two entities."[141] Second, "[the] distinction focuses the section on the culpable party and recognizes that the enterprise itself is often

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that conspiracy liability should apply "whenever two or more agents of the same corporation are involved").

In antitrust law, the Supreme Court has rejected the intracorporate conspiracy doctrine. Copperweld Corp. v. Independence Tube Corp., 467 U.S. 752, 777 (1984). This ruling, however, is based on the rationale that the doctrine does not serve the purpose of antitrust law under § 1 of the Sherman Act. *Id.* at 767–77; *see also* Milton Handler & Thomas A. Smart, *The Present Status of the Intracorporate Conspiracy Doctrine*, 3 CARDOZO L. REV. 23, 24–25 (1981) (since doctrine is "designed to prevent concerted action between distinct economic entities, . . . [it] does not promote competition"). By comparison, the law of *criminal* conspiracy seeks to attack the enhanced threat posed by group conduct. Since multiple agents of the same corporation may pose such a threat, the criminal law usually allows for intracorporate conspiracies composed of multiple agents of a single corporation. Sarah N. Welling, *Intracorporate Plurality in Criminal Law*, 33 HASTINGS L.J. 1155, 1197–1201 (1982). Under such circumstances, the corporation may be vicariously liable if the agents acted within the scope of their employment and with an intent to benefit the principal. *See id.* at 1200; *infra* note 149. As RICO is concerned with an aggravated form of criminality, *supra* notes 2, 31 and accompanying text, rather than attacking economic combinations, intracorporate conspiracies are within the scope of RICO. Furthermore, in *Copperweld* the Supreme Court stressed that precluding intracorporate conspiracies under § 1 of the Sherman Act would not eliminate antitrust enforcement. 467 U.S. at 777. In contrast, decisions such as *Computer Sciences* threaten to eviscerate RICO.

[138] *See supra* note 5 and accompanying text. *See, e.g.*, Hirsch v. Enright Ref. Co., 751 F.2d 628, 633–34 (3d Cir. 1984); Rae v. Union Bank, 725 F.2d 478, 481 (9th Cir. 1984).

[139] *See supra* note 9 and accompanying text.

[140] *See, e.g.*, Schofield v. First Commodity Corp., 793 F.2d 28, 29–34 (1st Cir. 1986) (collecting cases). Only the Fifth Circuit has rejected the person/enterprise doctrine. *See* United States v. Hartley, 678 F.2d 961, 988 (5th Cir. 1982).

[141] Bennett v. United States Trust Co., 770 F.2d 308, 315 (2d Cir. 1985), *cert. denied*, 474 U.S. 1058 (1986); *see also Schofield*, 793 F.2d at 30.

a passive instrument or victim of the racketeering activity."[142] Finally, since the legislative history of RICO indicates that "the primary purpose [was] . . . 'to cope with the infiltration of legitimate businesses,' it is logical that Congress would have designed section 1962(c) so that it reached the criminal but protected the victimized enterprise from liability."[143]

These justifications are illusory. First, section 1962(c) does not "clearly envision[] two entities." Rather, its text envisions a person and an enterprise. Since RICO's definition of both person and enterprise includes "any . . . entity,"[144] the statute contemplates the possibility of overlap between a person/entity and the enterprise.[145]

Second, while it is true that section 1962(c) "recognizes that the enterprise itself is often a passive instrument or victim of the racketeering activity,"[146] section 1962(c) also reaches perpetrator enterprises. Indeed, the Supreme Court's *Turkette* decision found this reach instrumental to the major purpose of RICO.[147] The legislative history supports this view as well.[148] Moreover, since corporate criminality is necessarily vicarious, pre-existing principles of vicarious liability independently preclude liability when the corporation is the passive instrument or victim of someone else's criminality.[149] Thus, the person/enterprise distinction is both redundant and unduly broad, since it simultaneously protects both innocent entities, which are already protected, and perpetrator entities, which merit no protection.

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[142] *Bennett*, 770 F.2d at 315; *see also* Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 401 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985).

[143] *Schofield*, 793 F.2d at 31.

[144] *See supra* notes 27–28.

[145] Thus, another commentator has observed: "The notion that the statutory language precludes enterprise liability under section 1962(c) is questionable on its face. Although 'self-associated' is not vernacular, 'self-employed' is hardly archaic. Notably, courts have permitted sole proprietorships to fill both the 'enterprise' and the 'person' roles." Henry A. LaBrun, Note, *Innocence by Association: Entities and the Person-Enterprise Rule Under RICO*, 63 NOTRE DAME L. REV. 179, 200 (1988).

[146] *Bennett*, 770 F.2d at 315.

[147] *Turkette*, 452 U.S. at 591–93; *see also supra* notes 46–55 and accompanying text.

[148] *See* Goldsmith, *supra* note 20, at 776–84 (reviewing legislative history and the development of § 1962(c)). *But see* Lynch, *supra* note 23, at 680–85 (arguing that the application of RICO to white collar crime goes far beyond the congressional concern with protecting legitimate enterprises from organized criminal infiltration).

[149] KATHLEEN F. BRICKEY, CORPORATE CRIMINAL LIABILITY 83 (1984) (noting requirement of intent to benefit corporation as a prerequisite to vicarious liability); *see also* LAFAVE & SCOTT, *supra* note 137, at 260–62; *infra* note 158 and accompanying text.

Third, though the enactment of RICO principally reflected a concern with the infiltration of legitimate businesses by organized crime, the record is also clear that Congress sought a broadly based statute capable of addressing a variety of complex criminal problems.[150] Thus, perpetrator white-collar enterprises fit within the intended scope of RICO. By focusing exclusively on RICO's initial concern with organized-crime infiltration activities, the person/enterprise rule effectively reads the organized-crime limitation—which the Supreme Court in *H.J. Inc.* expressly discredited[151]—back into the statute.

Finally, the decisions applying the person/enterprise distinction both disregard the liberal construction clause and create the likelihood of absurd results by conferring immunity on perpetrator white-collar institutions.[152] Thus, the decisions violate basic rules of statutory construction[153] and ignore all Supreme Court precedent in this area.[154]

For the most part, the person/enterprise distinction initially hurt civil plaintiffs rather than public prosecutors. The Department of Justice has not suffered serious adverse effects from the rule because it has filed relatively few RICO prosecutions against white-collar institutions.[155] On the civil side, however, the requirement regularly led to decisions adverse to plaintiffs who brought RICO claims against white-collar institutions.[156]

In response, plaintiffs' counsel adopted a variety of tactics to plead around the limitation. Some failed utterly and, though others partially succeeded, all of them may soon succumb to recent expansive interpretations of the person/enterprise rule.

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[150] *See supra* notes 26–31 and accompanying text.

[151] 492 U.S. at 243–49; *see also supra* notes 99–103 and accompanying text.

[152] *See* Ad Hoc Civil RICO Task Force, *Report of the Ad Hoc Civil RICO Task Force*, 1985 A.B.A. SEC. CORP. BANKING & BUS. LAW 374–76 (criticizing "a general rule that applies even when the enterprise is *not* the victim, but is instead the perpetrator"); LaBrun, *supra* note 145, at 201 ("Although the person-enterprise [rule] protects victims, it also protects perpetrators. As such the rule is both dangerous and superfluous.").

[153] *See supra* notes 46–52.

[154] *See supra* notes 41–105.

[155] For example, between 1984 and 1991, the Department of Justice approved 833 RICO prosecutions. Of these, only 131 involved allegations of fraud. Memorandum from Channing D. Phillips, Organized Crime & Racketeering Section, U.S. Dep't of Justice, to Gary Hill, Reference Librarian, J. Reuben Clark Law School, Brigham Young University (Nov. 25, 1992) (on file with the *Harvard Journal on Legislation*). However, "[m]ore recently, RICO has been applied to extensive white-collar criminality, including insider-trading of securities and bank failures caused by criminal fraud." Dennis, *supra* note 35, at 653 (footnotes omitted).

[156] *See, e.g.*, Hirsch v. Enright Ref. Co., 751 F.2d 628, 633–34 (3d Cir. 1984); Rae v. Union Bank, 725 F.2d 478, 481 (9th Cir. 1984).

These recent interpretations threaten to create outright immunity for many white-collar defendants sued under RICO. To appreciate the significance of these decisions, the jurisprudence evolving from the person/enterprise distinction must be fully understood.

2. Expansion of the Person/Enterprise Doctrine

The person/enterprise doctrine evolved in response to efforts by plaintiffs to circumvent the limitation. Plaintiffs resorted to various theories involving *respondeat superior* or alternative enterprise designations. Each of these theories merits consideration.

Plaintiffs initially hoped to avoid the person/enterprise rule by relying upon *respondeat superior* liability. Under this approach, the complaint would name corporate officers as the RICO defendants and designate the corporation as the enterprise. In a separate claim, the complaint would then charge that the corporation is vicariously liable for the conduct of company employees.[157]

This theory of corporate responsibility met with judicial disdain in actions brought under section 1962(c). The courts rejected *respondeat superior* as an artificial effort to plead around the person/enterprise requirement. Moreover, the decisions reasoned that, given the purpose of RICO to protect enterprises from organized-crime infiltration, it made no sense to allow vicarious liability against a corporate victim or passive instrumentality of employee wrongdoing.[158]

These rulings, however, are inconsistent with basic principles of *respondeat superior*. Since a corporation is a legal entity capable of acting *only* through its employees, corporate liability may *only* be vicarious. Such liability is justified both because the principal potentially benefits from the agent's conduct and because the principal is in the best position to control the agent's conduct.[159] A threshold requirement of vicarious liability in

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[157] *See* LaBrun, *supra* note 145, at 202–03; 15 RICO L. Rep. 468, 554–55 (1992) (collecting cases).

[158] *See, e.g.*, Petro-Tech, Inc. v. Western Co., 824 F.2d 1349, 1358–60 (3d Cir. 1987); Schofield v. First Commodity Corp., 793 F.2d 28, 32–33 (1st Cir. 1986) (collecting cases).

[159] BRICKEY, *supra* note 149, at 84; W. PAGE KEETON, PROSSER AND KEETON ON THE LAW OF TORTS § 69, at 500 (5th ed. 1984).

criminal cases, however, is that the agent intend to benefit the principal.[160] Therefore, by definition, *respondeat superior* doctrine in criminal cases exempts from liability *any* principal that is a victim or passive instrumentality of criminality. Because these principles apply to civil RICO (except insofar as courts reject their applicability to section 1962(c) claims), the person/enterprise distinction is not needed to protect innocent enterprises.

Moreover, Congress wrote RICO within a context of jurisprudence that uniformly sustained vicarious liability.[161] As nothing within RICO's text or legislative history suggests that traditional principles of *respondeat superior* ought not apply to section 1962(c), decisions rejecting this doctrine under the guise of the person/enterprise distinction are fundamentally in error. Given the force of these decisions, however, RICO victims needed a different theory of liability against culpable enterprises. At least initially, section 1962(a) provided a potentially viable alternative means of relief.

Congress conceived section 1962(a) as an anti-money laundering provision aimed at preventing racketeering proceeds from being invested in legitimate enterprises.[162] Thus, the provision makes it unlawful for a principal to invest racketeering proceeds in an enterprise.[163] In contrast to section 1962(c), this prohibition does not expressly require the violator to be a "person, employed by or associated with any enterprise."[164] On this basis, most courts have held that the person/enterprise distinction does

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[160] BRICKEY, *supra* note 149, at 84. In civil cases, intent to benefit is not needed so long as the agent acted with apparent authority. HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 226 (3d ed. 1983). This rule is widely applied in the federal courts. *See* American Soc'y of Mechanical Eng'rs v. Hydrolevel Corp., 456 U.S. 556, 567 (1982) ("The apparent authority theory has long been the settled rule in the federal system."). As RICO is part of the criminal code and is principally concerned with eradicating crime, principles of criminal vicarious liability are more appropriate than their civil counterparts. *See* United States v. Local 560, Int'l Bhd. of Teamsters, 581 F. Supp. 279, 332 n.30, 337 (D.N.J. 1984) (applying criminal rules of vicarious liability to civil RICO case), *aff'd*, 780 F.2d 267, 284 (3d Cir. 1985); Blakey & Cessar, *supra* note 9, at 582 n.235; LaBrun, *supra* note 145, at 191.

[161] *See, e.g., American Soc'y of Mechanical Eng'rs*, 456 U.S. at 565–70 (recognizing broad application of civil vicarious liability in antitrust case).

[162] *See supra* notes 22–23 and accompanying text.

[163] 18 U.S.C. § 1962(a); *see also supra* note 22.

[164] Rather, the text of § 1962(a) applies to "any person who has received any income derived, directly or indirectly, from a pattern of racketeering activity." 18 U.S.C. § 1962(a).

not apply to section 1962(a).[165] The textual difference between the two sections has also prompted the courts to sustain vicarious liability under section 1962(a), provided that the enterprise benefited from the racketeering activity.[166]

Ironically, the textual difference between section 1962(a) and (c) is illusory insofar as the person/enterprise doctrine is concerned. Since section 1962(a) makes it illegal for "any *person*" to invest racketeering proceeds "in acquisition of any interest in, or the establishment or operation of, any *enterprise*,"[167] the statutory terms are susceptible to the same fallacious argument made under section 1962(c): that Congress must have intended that the person/defendant and the enterprise be separate and distinct entities. The argument fails for the same reason that it ought to be rejected under section 1962(c): as the statute contemplates that both a person and an enterprise may be any entity, overlap between the person and the enterprise is not precluded[168]—especially given the liberal construction directive contained in RICO.[169] Liability should turn on whether the organization acts as a criminal perpetrator rather than on metaphysical questions of whether the person and enterprise are sufficiently distinct.[170]

Although premised on illusory grounds, section 1962(a) initially offered victims a potential way to plead around the section 1962(c) person/enterprise doctrine. Most courts, however, eventually precluded this option by imposing a new standing limitation on section 1962(a) claims: the need to prove an "investment injury." As section 1962(a) outlaws the investment of racketeering proceeds in an enterprise, the judiciary reasoned that recov-

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[165] *See* James D. Higgason, Jr., Note, *Enterprise Liability in Private Civil RICO Actions*, 45 WASH. & LEE L. REV. 1447, 1458-64 (1988) (collecting cases). These decisions are also based on the following rationale:

> This approach to subsection (a) thus makes the corporation-enterprise liable under RICO when the corporation is actually the direct or indirect beneficiary of the pattern of racketeering activity, but not when it is merely the victim, prize, or passive instrument of racketeering. This result is in accord with the primary purpose of RICO, which, after all, is to reach those who ultimately profit from racketeering, not those who are victimized by it.

Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 402 (7th Cir. 1984), *aff'd*, 473 U.S. 606 (1985).

[166] *See, e.g.*, 15 RICO L. Rep. 468, 555 (1992) (collecting cases).

[167] 18 U.S.C. § 1962(a); *see also supra* note 22.

[168] *See supra* notes 144-145 and accompanying text.

[169] 84 Stat. 947 (1970); *see also supra* note 10.

[170] *Cf.* Haroco, Inc. v. American Nat'l Bank & Trust Co., 747 F.2d 384, 401 (7th Cir. 1984) (recognizing person/enterprise distinction, but acknowledging its metaphysical tendencies), *aff'd*, 473 U.S. 606 (1985).

ery under this provision should be limited to victims who can prove injury from such investment rather than merely injury from the underlying racketeering activity.[171]

This judicial limitation, like its predecessors, has no principled support in the statute. The text contains no hint of any investment injury requirement. Indeed, for this reason, the Supreme Court rejected a comparable standing limitation in *Sedima*.[172] Moreover, the legislative history expressly asserts a desire to avoid imposing complex standing limitations on RICO.[173]

The investment injury limitation is also illogical from a policy standpoint. From the victim's perspective, it makes no difference how the violator uses profits generated by racketeering. The violator's treatment of illicit proceeds certainly does nothing to reduce the severity of the initial injury. Furthermore, in virtually all other contexts, the courts limit standing under RICO to persons claiming "direct" injuries.[174] As such direct injuries ordinarily flow from the racketeering activity, it makes no sense to limit recovery under section 1962(a) to investment injuries, which tend to be indirect in nature. Finally, because very few persons are injured by the investment of racketeering pro-

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[171] *See, e.g.*, Danielsen v. Burnside-Ott Aviation Training Ctr., Inc., 941 F.2d 1220, 1229 (D.C. Cir. 1991) (collecting cases); Rose v. Bartle, 871 F.2d 331, 357 (3d Cir. 1989). *See generally* Patrick D. Hughes, Note, *The Investment Injury Requirement in Civil RICO Section 1962(a) Actions*, 41 DEPAUL L. REV. 475, 514 (1992).

[172] *See supra* notes 78–80 and accompanying text. As with the discredited racketeering injury limitation, the investment injury rule requires some injury beyond that occurring from the commission of a predicate act. At the least, the Supreme Court's treatment of the analogous racketeering injury issue in *Sedima* should also be dispositive of the investment injury rule:

> [W]e perceive no distinct "racketeering injury" requirement. Given that "racketeering activity" consists of no more and no less than commission of a predicate act, § 1961(1), we are initially doubtful about a requirement of a "racketeering injury" separate from the harm of the predicate acts. A reading of the statute belies any such requirement. Section 1964(c) authorizes a private suit by "[a]ny person injured in his business or property by reason of a violation of § 1962." Section 1962 in turn makes it unlawful for "any person"—not just mobsters—to use money derived from a pattern of racketeering activity to invest in an enterprise, to acquire control of an enterprise through a pattern of racketeering activity, or to conduct an enterprise through a pattern of racketeering activity. *§§ 1962(a)-(c)*. If the defendant engages in a pattern of racketeering activity in a manner forbidden by these provisions, *and the racketeering activities injure the plaintiff in his business or property, the plaintiff has a claim under § 1964(c)*. There is no room in the statutory language for an additional, amorphous "racketeering injury" requirement.

Sedima, S.P.R.L. v. Imrex Co., 473 U.S. 479, 495 (1985) (emphasis added) (footnote omitted). The only circuit court to reject the investment injury rule relied, in part, on this portion of *Sedima*. Busby v. Crown Supply, Inc., 896 F.2d 833, 839 (4th Cir. 1990) (en banc).

[173] *See supra* note 12 and accompanying text.

[174] *See supra* note 112.

ceeds,[175] the artificial investment injury rule improperly denies relief to the vast majority of racketeering victims pleading under section 1962(a).[176] This result is inconsistent with RICO's broad remedial purpose, especially as reflected by the statute's liberal construction directive.[177]

Even so, the investment injury rule remains a firmly embedded statutory anomaly.[178] Because section 1962(a) no longer affords a viable theory of liability against institutional defendants, plaintiffs must return to section 1962(c) for possible solutions. Unfortunately, each potential strategy under that section has likewise proven to be problematic.

For example, if a corporate subsidiary exists, the subsidiary might be named as the enterprise and the perpetrator corporation as the person/defendant. This approach has its own problems. For instance, a nexus may exist between all of the racketeering activity and the corporation but not between each alleged racketeering activity and the subsidiary enterprise. Once predicates lacking any relationship to the enterprise are stricken, the requisite pattern may be lacking.[179] Moreover, even if the requisite pattern exists, many courts have ruled that a subsidiary is not sufficiently distinct to satisfy the person/enterprise doctrine.[180] Finally, the availability of a subsidiary to serve as the enterprise is necessarily dependent upon the facts of each case. Thus, it is certainly not an ever-ready pleading option.

Alternatively, the plaintiff may qualify as a victim enterprise.[181] Under such circumstances, the named defendant might

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[175] *Cf. Busby*, 896 F.2d at 839 (rejecting investment injury rule because *inter alia* it is virtually impossible to prove that the invested income caused the alleged injury).

[176] 15 RICO L. Rep. 87–89 (1992) (index of cases showing only four plaintiffs successfully pleading an investment injury). In rejecting the investment injury doctrine, the Fourth Circuit emphasized that few cases could ever meet this standard. *Busby*, 896 F.2d at 839.

[177] *See supra* note 10 and accompanying text.

[178] *See supra* note 171. In addition, many courts apply an analogous standing limitation under § 1962(b) by requiring proof of an "acquisition" type injury. *See, e.g.*, Danielsen v. Burnside-Ott Aviation Training Ctr., 941 F.2d 1220, 1231 (D.C. Cir. 1991); U.S. Concord, Inc. v. Harris Graphics Corp., 757 F. Supp. 1053, 1060 (N.D. Cal. 1991); Midwest Grinding Co. v. Spitz, 716 F. Supp. 1087, 1091 (N.D. Ill. 1989).

[179] *Cf.* Banks v. Wolk, 918 F.2d 418, 424 (3d Cir. 1990) (holding that predicates unrelated to same enterprise may not form part of pattern); Bastian v. Petren Resources Corp., 681 F. Supp. 530, 538 (N.D. Ill. 1988).

[180] *See* Odishelidze v. Aetna Life & Cas. Co., 853 F.2d 21, 23–24 (1st Cir. 1988); NCNB Nat'l Bank v. Tiller, 814 F.2d 931, 936 (4th Cir. 1987).

[181] A union or other takeover target of organized crime provides an obvious example of a victim enterprise. *See supra* note 129 and accompanying text. In other contexts, an institution may have been victimized by a long-term pattern of fraud. *See, e.g.*, Greyhound Fin. Corp. v. Willyard, No. 87-C-0811B, 1989 U.S. Dist. LEXIS 16040 (D. Utah Dec. 23, 1989).

be a person who conducted the affairs of the victim-enterprise. Here too, however, problems arise. For example, even though the defendant may have engaged in numerous acts of racketeering, relatively few of these predicate acts may have involved the plaintiff victim enterprise. Under such circumstances, the person/enterprise distinction may be overcome at the expense of meeting the pattern requirement.[182] Moreover, even absent pattern problems, the victim enterprise theory will fail in many jurisdictions because several circuit courts hold that, unless the defendant is involved in the management or operation of the enterprise, the defendant does not sufficiently "conduct or participate . . . in the conduct of such enterprise's affairs" under section 1962(c) to be held liable.[183] Though the text of section 1962(c) does not suggest any required level of participation,[184] this rule effectively precludes designating the victim as the enterprise whenever the defendant did not engage in a pattern of racketeering activity as a high-level insider of the enterprise. Thus, the victim/enterprise theory likewise fails to provide consistent relief against the strictures of the person/enterprise doctrine.

Until recently, the most promising remedy to this problem was to allege an associated-in-fact enterprise. RICO's enterprise definition includes among its possibilities a "group of individuals associated in fact."[185] As initially conceived, this terminology allowed the government to name an organized-crime family or other outlaw group as a RICO enterprise.[186] The Supreme Court's decision in *Turkette* sustained this doctrine.[187] Accordingly, in response to the person/enterprise rule, RICO plaintiffs began to name institutional entities as the person/defendant and to designate the enterprise as the defendant and other individ-

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[182] *See supra* note 179 and accompanying text.

[183] *See* Arthur Young & Co. v. Reves, 937 F.2d 1310, 1323–24 (8th Cir.) (en banc), *cert. granted*, 112 S. Ct. (1991); Yellow Bus Lines, Inc. v. Drivers, Chauffeurs & Helpers Local Union 639, 913 F.2d 948, 952–54 (D.C. Cir.), *cert. denied*, 111 S. Ct. 2839 (1991); United States v. Mandel, 591 F.2d 1347, 1375–76 (4th Cir. 1979), *cert. denied*, 445 U.S. 959, 961 (1980).

[184] On the contrary, the text of § 1962(c) expressly reaches both direct and indirect conduct. *See* 18 U.S.C. § 1962(c).

[185] *Id.* § 1961(4).

[186] *See, e.g.*, United States v. Salerno, 868 F.2d 524, 528–29 (2d Cir.) (mob "commission" as enterprise), *cert. denied*, 491 U.S. 907 (1989); United States v. Yarbrough, 852 F.2d 1522, 1526–28 (9th Cir.) (white hate group), *cert. denied*, 488 U.S. 866 (1988); United States v. Chang An-Lo, 851 F.2d 547, 550–60 (2d Cir.) (United Bamboo Syndicate), *cert. denied*, 488 U.S. 966 (1988).

[187] *See supra* notes 43–56 and accompanying text.

uals and/or entities "associated in fact." Even though this pleading tactic named the defendant as part of the enterprise, courts had little choice but to sustain this approach: the association in fact is the classic RICO enterprise in organized-crime prosecutions, and rejecting this theory outright would have eviscerated RICO where Congress most obviously intended the law to apply.[188] Thus, most courts properly held that the person/enterprise distinction does not apply to associated-in-fact enterprises.

However, the associated-in-fact theory had its own problems. The courts ruled that a group that consists exclusively of a corporation and its employees does not qualify as an association in fact because it merely reflects the composition of a single legal entity. Since a corporation acts only through its employees, naming these employees as part of an enterprise does not change the reality that the corporation itself is serving as the enterprise.[189]

As a consequence of these decisions, the option of pleading an associated-in-fact enterprise theory exists only when the institutional defendant has acted in concert with someone—either an individual or another legal entity—with a legal status independent of the defendant.[190] In other words, this theory of liability requires an extra-corporate conspiracy of some kind, and such a claim will not succeed when the corporate defendant is the sole perpetrator.

Finally, recent case law suggests that even this theory of liability may soon be eliminated. In *Brittingham v. Mobil Corp.*,[191] the Third Circuit essentially removed this pleading

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[188] For example, in refusing to apply the person/enterprise distinction to an association in fact, the Eighth Circuit recognized the consequences of such a holding under criminal RICO: "If five persons form an association in fact and engage in a pattern of racketeering activity such as drug smuggling and murder, an individual member could never be prosecuted for violating RICO under [this] reasoning because he or she would not be considered distinct from the enterprise." Atlas Pile Driving Co. v. DiCon Fin. Co., 886 F.2d 986, 995 (8th Cir. 1989); *see also* Roeder v. Alpha Indus., Inc., 814 F.2d 22, 28–29 (1st Cir. 1987); Cullen v. Margiotta, 811 F.2d 698, 729–30 (2d Cir. 1987) (holding that legal entity may be part of association in fact).

[189] *See, e.g.*, Entre Computer Ctrs., Inc. v. FMG of Kansas City, Inc., 819 F.2d 1279, 1287 (4th Cir. 1987), *overruled by* Busby v. Crown Supply Inc., 896 F.2d 833 (4th Cir. 1990); Atkinson v. Anadarko Bank & Trust Co., 808 F.2d 438, 440–41 (5th Cir.), *cert. denied*, 483 U.S. 1032 (1987).

[190] Even then, to ensure that the association in fact consists of more than an ad hoc group, several courts quite properly require additional proof demonstrating that there is some structure, continuity, and common purpose to the enterprise. *See, e.g.*, Seville Indus. Mach. Corp. v. Southmost Mach. Corp., 742 F.2d 786, 789–90 (3d Cir. 1984), *cert. denied*, 469 U.S. 1211 (1985); Bennett v. Berg, 685 F.2d 1053, 1060–62 (8th Cir. 1982), *aff'd on reh'g*, 710 F.2d 1361 (8th Cir. 1983) (en banc).

[191] 943 F.2d 297 (3d Cir. 1991).

option within its jurisdiction. Ironically, the Third Circuit had previously been at the forefront of decisional authority recognizing the need to impose liability on perpetrator enterprises that benefit from their employees' wrongdoing.[192] While the Third Circuit followed the person/enterprise rule, the circuit had held that *respondeat superior* liability still applied so long as the defendant was not also named as the RICO enterprise.[193] Since this situation often occurred in the context of associated-in-fact enterprises comprised of the defendant and other independent entities, the Third Circuit had previously declined to apply the person/enterprise rule to associated-in-fact enterprises.[194]

Brittingham, however, ignored Third Circuit precedent and severely limited the ability of RICO plaintiffs to plead an associated-in-fact enterprise theory that includes an institutional defendant. In *Brittingham*, plaintiffs brought a false advertising RICO claim against the Mobil Corporation. To avoid the person/enterprise rule, plaintiffs alleged an associated-in-fact enterprise consisting of Mobil, its employees, *and outside advertising agencies*.[195] Under established jurisprudence, inclusion of the outside advertising agencies—which obviously had an independent legal existence—provided the basis for a valid associated-in-fact enterprise, because the enterprise did not merely consist of the corporate defendant and its employees.[196]

Writing as though no prior jurisprudence existed, the Third Circuit ruled that the alleged associated-in-fact enterprise ran afoul of the person/enterprise rule.[197] Despite the fact that the plaintiffs had alleged outside entities as part of the association in fact, the Court rejected the pleading because "a § 1962(c) enterprise must be more than an association of individuals *or entities* conducting the normal affairs of a defendant corporation."[198] The Court failed to explain why inclusion of outside

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[192] *See* Petro-Tech, Inc. v. Western Co. of N. Am., 824 F.2d 1349, 1361–62 (3d Cir. 1987) (allowing corporation to be named as a defendant that is also part of an associated-in-fact enterprise). Commentators have interpreted *Petro-Tech* as applying to perpetrator institutions. *See* O'Neill, *supra* note 21, at 668–69 ("*Petro-Tech* means that a corporation that is a member of an association-in-fact enterprise could be held directly liable for the acts of the association.").

[193] *Petro-Tech*, 824 F.2d at 1361–62.

[194] *See* Shearin v. E.F. Hutton Group, Inc., 885 F.2d 1162, 1165–66 (3d Cir. 1989); *Petro-Tech*, 824 F.2d at 1361–62.

[195] *Brittingham*, 943 F.2d at 303.

[196] *See supra* notes 185–190 and accompanying text.

[197] *Brittingham*, 943 F.2d at 301–03.

[198] *Id.* at 301 (emphasis added).

entities no longer sufficed to state a valid claim; at best, the decision merely implied that outside entities that "carry out [the defendant's] actions" do not make the association in fact sufficiently distinct from the institutional defendant.[199] The Court stated: "Without allegations or evidence that the defendant corporation had a role in the racketeering activity that was distinct from the undertakings of those acting on its behalf, the distinctiveness requirement is not satisfied."[200]

This holding is wrong. It ignores the fact that the outside entities enjoyed an independent legal status as corporations or partnerships. Furthermore, in every conspiracy, the conspirators act as each other's agents; by definition, they act on each other's behalf.[201] By suggesting that an association in fact does not survive the person/enterprise rule when its members act on each other's behalf, the Third Circuit both ignored prevailing conspiracy doctrine and made it virtually impossible to plead a valid associated-in-fact enterprise theory under RICO. Moreover, by removing the last remaining vehicle for suing perpetrator institutions under section 1962(c), the Third Circuit has effectively created outright enterprise immunity under civil RICO. Fraud victims are left with remedies that have failed in the past and are unlikely to succeed in the future.[202]

Because RICO's prohibitions apply with equal force to civil and criminal litigation, *Brittingham* is also likely to impede the prosecution of white-collar institutional violators.[203] Even worse, *Brittingham* and subsequent Third Circuit decisions

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[199] *Id.* at 302. Apparently, the Court viewed these outside entities as mere "agents." *Id.* at 303.

[200] *Id.* at 302.

[201] Pinkerton v. United States, 328 U.S. 640, 645–47 (1946); *see also* ROLLIN M. PERKINS & RONALD N. BOYCE, CRIMINAL LAW 701–02 (3d ed. 1982) ("It is hornbook law that a conspirator is criminally responsible for the acts of his co-conspirators which are committed in furtherance of the common design even though he was not present when the acts were committed."). As Judge Learned Hand observed: "When men enter into an agreement for an unlawful end, they become ad hoc agents for one another, and have made 'a partnership in crime.'" Van Riper v. United States, 13 F.2d 961, 967 (2d Cir.), *cert. denied*, 273 U.S. 702 (1926); *see also* LAFAVE & SCOTT, *supra* note 137, at 588 (noting agency theory though criticizing its scope).

[202] *See* Blakey & Perry, *supra* note 5, at 909–16 (explaining inadequacy of existing alternatives and documenting problem of fraud in society); Goldsmith, *supra* note 8, at 834–37 (explaining advantages of civil RICO over other remedies).

[203] In the Third Circuit, for example, the Department of Justice will no longer be able to name an institutional violator as both a defendant and a member of an associated-in-fact enterprise. Given the prevailing judicial hostility to civil RICO, other courts are likely to follow *Brittingham*. When that occurs, prosecutorial efforts will be hampered nationwide.

threaten to confer RICO immunity upon individual violators as well.

C. *Individual Immunity*

Although *Brittingham* will have its most immediate effect on litigation aimed at perpetrator enterprises, it will also create problems of individual immunity. Problems will arise for at least two reasons. First, given the sweeping terms in which *Brittingham* precludes a valid associated-in-fact enterprise whenever its members *act on each other's behalf*,[204] the same analysis potentially applies to any organized-crime family or outlaw gang whose members join together for a common illicit purpose. *Brittingham* thus enables defense counsel to claim that criminals acting on each other's behalf through a common association are not sufficiently distinct from the enterprise to be prosecuted under RICO.[205]

Second, *Brittingham* has already generated another decision that may provide individual white-collar violators with special immunity. In *Glessner v. Kenny*,[206] the Third Circuit both reaffirmed the person/enterprise rule and interpreted *Brittingham* potentially to preclude individual defendants—such as corporate officers or employees—from meeting the distinctiveness requirement *even when the corporation has not been named as a defendant*.[207] Because the individual defendants did not engage in any activities distinct from those activities designed to benefit their perpetrator corporate enterprise, the Third Circuit found that the person/enterprise rule precluded *individual* liability.[208]

This decision finds no support in the statutory text, which explicitly reaches persons "employed by or associated with an

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[204] *See supra* note 200 and accompanying text.

[205] Faced with this argument, the Third Circuit will either retreat from *Brittingham* or strain to avoid its consequences. This would not be the first time that an appellate court realizes the adverse effects of a narrow civil RICO ruling only when the issue arises in a criminal context. For example, the Eighth Circuit initially created the restrictive multiple-scheme requirement for the pattern element in a civil case. Superior Oil Co. v. Fulmer, 785 F.2d 252, 256–57 (8th Cir. 1986). Later, the Eighth Circuit strained to avoid the consequences of this standard in a narcotics prosecution by finding that each contraband drug involved a separate criminal scheme. *See* United States v. Kragness, 830 F.2d 842, 858 (8th Cir. 1987).

[206] 952 F.2d 702 (3d Cir. 1991).

[207] *Id.* at 713–14.

[208] *Id.*

enterprise."[209] *Glessner* also ignores the obvious fact that individual employees enjoy an *actual* existence independent of their corporate employer. Furthermore, neither the legislative history nor the policy considerations underlying RICO suggest an intent to protect individuals engaged in corporate crime from liability. Taken to an extreme, the absurd message suggested by *Glessner* for organized-crime groups is clear: incorporate formally into perpetrator enterprises and you will enjoy immunity from RICO.[210]

Fortunately, neither *Brittingham* nor *Glessner* have yet developed a following outside of the Third Circuit.[211] Nevertheless, if prior history is any indication, other courts will soon seize upon these decisions as a way to curtail civil RICO. As civil and criminal RICO operate under identical texts, the ultimate consequence threatens to be the demise of the entire statute.[212] If such a result is to be avoided, strong countermeasures must be taken.

IV. THE NEED FOR CORRECTIVE COUNTERMEASURES

If RICO is to be saved from judicial reform, there must be a return to basic principles of statutory construction. To its credit,

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[209] 18 U.S.C. § 1962(c).

[210] Fortunately, RICO presently sends organized-crime members precisely the opposite message. In one prominent case, for example, a mobster complaining about RICO was recorded as stating that "they can stick RICO . . . I wouldn't be in a legitimate business for all the . . . money in the world." William F. Doherty, *On FBI Tape at Trial, Anguilo Swears Off "Legitimate Business"*, BOSTON GLOBE, Aug. 24, 1985, at 17.

[211] One other circuit court, however, has suggested that corporate employees are not sufficiently distinct from the corporate enterprise. *See* Entre Computer Ctrs., Inc. v. FMG of Kansas City, 819 F.2d 1279, 1287 (4th Cir. 1987), *overruled by* Busby v. Crown Supply, Inc., 896 F.2d 833 (4th Cir. 1990). Furthermore, other circuits are beginning to interpret the enterprise element rigidly. *See* Parker & Parsley Petroleum Co. v. Dresser Indus., 972 F.2d 580, 584 (5th Cir. 1992) (rejecting enterprise because corporate partners "committed the predicate acts . . . in the course of their regular business"). Finally, within the Third Circuit, *Glessner* and *Brittingham* are producing predictable effects. *See* T.I. Constr. Co. v. Kiewit Eastern Co., 1992 U.S. Dist. Lexis 11607 (E.D. Pa. Aug. 5, 1992) (rejecting associated-in-fact enterprise notwithstanding distinct legal entities); Korman v. Trusthouse Forte PLC, 786 F. Supp. 458, 461 (E.D. Pa. 1992) (rejecting enterprise because related corporate entities may not be both enterprise and defendants).

[212] At the very least, federal prosecutors will need to foresake § 1962(c) in favor of § 1962(a) and (b). By that time, however, the various limitations imposed upon subsections (a) and (b) in a civil context may likewise impede criminal prosecutions. *Cf.* Official Publications, Inc. v. Kable News Co., 884 F.2d 664, 668 (2d Cir. 1988) (suggesting that person/enterprise rule also applies to § 1962(b)). On the civil side, these limitations threaten to leave victims without any RICO remedy.

the Supreme Court has adhered to traditional standards which hold that the statutory text provides the best indication of congressional intent.[213] Notwithstanding its dissatisfaction with aspects of RICO, the Supreme Court has declined to narrow the statute by reading it restrictively in light of its legislative history. Indeed, the Court's handling of this issue parallels its treatment of other organized-crime legislation—none of which has ever been confined to its original organized-crime roots.[214]

Ample opportunity still exists for the Supreme Court to correct current jurisprudence. Although the vast majority of decisions have adopted the person/enterprise and investment injury rules, a split of authority remains among lower courts.[215] Therefore, appropriate grounds exist for a grant of *certiorari* to resolve these issues.

There is little reason to believe, however, that the Supreme Court will act soon. Civil RICO does not enjoy widespread support, and several justices have expressed their discontent with the statute.[216] Perhaps for this reason, the Court has previously denied applications for *certiorari* involving these very issues.[217] However, since the misguided holdings of the lower courts threaten also to undermine both criminal RICO and other statutes generally,[218] there is ample incentive for the Supreme Court to direct the judiciary to cease meddling in the legislative process.

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[213] *See supra* notes 42–103 and accompanying text.

[214] *See* G. Robert Blakey, *Definition of Organized Crime in Statutes and Law Enforcement Administration, in* PRESIDENT'S COMM'N ON ORGANIZED CRIME, REPORT TO THE PRESIDENT AND THE ATTORNEY GENERAL, THE IMPACT OF ORGANIZED CRIME TODAY 1, 511–80 (1986) (extensive analysis of judicial decisions aimed at organized crime).

[215] *See* Busby v. Crown Supply, Inc., 896 F.2d 833, 837-40 (4th Cir. 1990) (en banc) (rejecting investment injury rule); United States v. Hartley, 678 F.2d 961, 988 (11th Cir. 1982), *cert. denied,* 459 U.S. 1170 (1983) (only jurisdiction to reject person/enterprise rule); Hughes, *supra* note 171, at 494–95 (1992) (observing that some circuit courts have not resolved the investment injury issue).

[216] *See supra* note 14 and accompanying text.

[217] *See, e.g.,* Grider v. Texas Oil & Gas Corp., 868 F.2d 1147, 1150–51 (10th Cir.) (adopting investment injury rule), *cert. denied,* 493 U.S. 820 (1989); Bennett v. United States Trust Co., 770 F.2d 308, 315 (2d Cir. 1985) (adopting person/enterprise rule), *cert. denied,* 474 U.S. 1058 (1986) .

[218] In other words, if the Supreme Court permits the lower courts to rewrite RICO, any other federal statute is likewise vulnerable to judicial revision. The legislative process is undermined as a consequence. *See* Pillow v. Roberts, 54 U.S. 472, 476 (1851) ("It is easy by very ingenious and astute construction, to evade the force of almost any statute, where a court is so disposed . . . . Such a construction annuls . . . the law, and renders it superfluous and useless."); 3 ROSCOE POUND, JURISPRUDENCE 488–502 (1959) (discussing interpretative abuses by judges).

Absent corrective countermeasures by the Supreme Court, Congress must be prepared to revitalize RICO. In recent years, however, most RICO reform proposals have sought to curtail the statute.[219] If enacted, these proposals would go well beyond simply protecting white-collar institutions from the risk of abusive litigation. Indeed, the proposed reforms need to be modified to achieve a better balance between protecting institutional defendants and advancing victims' rights.[220] Congress, however, has never expressed any enthusiasm for expanding RICO, and so the desired balance is not likely to be attained.

The restrictive reform likely to occur surely precludes any need for artificial judicial protections that eliminate traditional doctrines such as *respondeat superior* liability from RICO. Accordingly, such reform must explicilty restore vicarious liability and eliminate the person/enterprise distinction as a requirement *whenever the institutional defendant has acted as a criminal perpetrator.* Likewise, since the investment injury rule bars virtually all civil RICO litigation under section 1962(a), Congress should remove investment injury as a requirement for RICO standing.

Beyond that, Congress should resurrect RICO's liberal construction clause by expressly directing the judiciary to interpret the revised statute in a manner that effectuates its broad remedial purpose.[221] Absent such direction, the judiciary will surely try again to rewrite the statute.

V. Conclusion

In the two decades since its enactment, RICO has served as a powerful tool against enterprise criminality. Most of this success, however, has been achieved through criminal prosecu-

[219] *See supra* note 16 and accompanying text. *See generally* Bruce Haber, Note, *Congress Responds to Sedima: Is There a Contract Out on Civil RICO?*, 19 Loy. L.A. L. Rev. 851 (1986).

[220] Given the severity of white-collar fraud in American society, *supra* note 8, RICO needs to be moderated rather than eviscerated. *See* Blakey & Perry, *supra* note 5, at 926–79 (proposing a more balanced legislative reform package because the "central thrust of the proposed legislation . . . will tilt RICO litigation sharply in favor of defendants and inhibit the ability of victims of crime . . . to vindicate their rights"); Goldsmith, *supra* note 8, at 848–82 (criticizing previous proposal for lack of balance and proposing a more balanced approach); Michael Goldsmith & Mark Jay Linderman, *Civil RICO Reform: The Gatekeeper Concept*, 43 Vand. L. Rev. 735, 758–67 (1990) (arguing that reform proposal goes too far in favor of institutional defendants).

[221] *Cf.* Dickerson, *supra* note 105, at 262–81; 3 Norman J. Singer, Statutes and Statutory Construction § 57.01–.26 (5th ed. rev. 1992).

tions. The private attorney general concept underlying civil RICO has not achieved comparable results. Judging from the number of RICO suits filed, this failure does not reflect a lack of effort. Rather, the record demonstrates that negative judicial activism has kept RICO from achieving its potential.

Recently, the Third Circuit expressed chagrin "about the alacrity with which plaintiffs appear to grasp at any theory of alignment of parties which might withstand dismissal," and warned that "[a] RICO complaint is not a mix and match game in which plaintiffs may artfully invoke magic words to avoid dismissal."[222] In truth, however, RICO has become very much a game of mix and match because of the arcane complexities imposed upon the statute by the courts.

Since civil RICO first captured judicial attention, the lower courts have systematically sought to dismantle the civil remedy. Despite a series of Supreme Court decisions rejecting various judicially imposed limitations, the lower courts have continued to create numerous obstacles to civil RICO litigation. By developing and expanding upon the person/enterprise doctrine, the courts have now created virtual RICO immunity for perpetrator white-collar institutions. These decisions ignore both the statutory basis for targeting white-collar enterprises and the current need to combat fraud in American society. Even worse, these decisions now threaten to confer RICO immunity upon individual violators in both civil *and criminal* cases. Thus, the lower courts may have succeeded in undermining the aspect of the law that Congress clearly intended to have maximum impact.

To many judges, RICO may epitomize the adage that one ought never watch "laws and sausages . . . being made."[223] However, the lower courts have proven themselves far worse than their legislative counterparts in giving RICO a coherent and practical design. Either the Supreme Court or Congress must remedy this situation. A variety of countermeasures can be taken—provided that the judicial or legislative will to do so exists. In the meantime, the lower courts should desist from further judicial reform and abide by the Supreme Court's refrain concerning RICO: "The short answer is that Congress did not write the statute that way."[224]

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[222] Glessner v. Kenny, 952 F.2d 702, 714 (3d Cir. 1991).

[223] The full quotation reads: "If you like laws and sausages, you should never watch either one being made." LIBRARY OF CONGRESS, RESPECTFULLY QUOTED 190 (Suzy Platt ed., 1989) (quotation widely attributed to Otto Von Bismarck).

[224] Russello v. United States, 464 U.S. 21, 23 (1983) (quoting United States v. Naftalin, 441 U.S. 768, 773 (1979)).

ARTICLE

DIVORCE OBLIGATIONS AND BANKRUPTCY DISCHARGE: RETHINKING THE SUPPORT/PROPERTY DISTINCTION

JANA B. SINGER*

The Bankruptcy Code currently divides divorce-related obligations into two categories: awards or agreements in the nature of support are non-dischargeable; obligations arising from property divisions can be discharged in the same manner as ordinary commercial debts. Because recent developments in family law have undermined the support/property distinction and because privately negotiated divorce agreements often fail to distinguish between payments intended to serve as support and those intended to distribute property, the Code's reliance on this classification often leads to confusion and hardship for divorce obligees. In addition, because of the rise of equitable distribution as the dominant method of allocating marital gains and losses, the policy of refusing to protect divorce-related property divisions is unfair to divorcing couples who structure their financial arrangements according to modern notions of marital partnership.

Tracing the history of the marital support exemption and examining recent trends in family law, Professor Singer argues that the goals of bankruptcy law and divorce law could be better served by amending the Bankruptcy Code to exclude from discharge all divorce-related obligations. Such a rule would recognize the particular nature of financial commitments arising out of marriage, and allow the Code to conform with our modern understanding of the marriage relationship.

Both divorce and bankruptcy law attempt to balance an individual's interest in a fresh financial start with the obligation to honor family commitments. Modern divorce law does this by allowing easy exit from marriage, but requiring divorcing spouses to support their children and to apportion equitably between themselves the economic gains and losses attributable to their marriage.[1] Federal bankruptcy law currently strikes this balance by allowing debtors to discharge divorce-related financial obligations unless a court determines that a particular ob-

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* Associate Professor of Law, University of Maryland Law School. B.A., Dartmouth College, 1977; J.D., Yale Law School, 1982. The author would like to thank Karen Czapanskiy, Robert Levy, Richard Medales, Robin West, and Joan Williams for their helpful comments on earlier drafts of the Article.

[1] *See* Joan M. Krauskopf, *Theories of Property Division/Spousal Support: Searching for Solutions to the Mystery*, 23 FAM. L.Q. 253, 256 (1989).

ligation is "in the nature of alimony, maintenance or support."[2] Divorce awards or agreements that constitute or reflect property division, rather than support obligations, are dischargeable under the current Bankruptcy Code; bankruptcy thus extinguishes these obligations and renders them unenforceable through the divorce decree or by other means.[3]

The potential conflict between these two ways of balancing individual and family interests is made concrete when divorce and bankruptcy intersect. In particular, when bankruptcy follows on the heels of a divorce—an increasingly common chain of events—bankruptcy law can significantly reorder the balance that state divorce law establishes between an individual's interest in a fresh financial start and his obligation to honor financial commitments arising out of marriage.

Although a certain tension has always existed between the goals of divorce and bankruptcy law, the Bankruptcy Code's purported distinction between nondischargeable marital support obligations and dischargeable property debts arguably represented an acceptable compromise as long as two critical assumptions held true. First, that obligations described as property divisions differed substantively from those described as support. Second, that awards of spousal support—rather than

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[2] Section 523(a)(5) of the Bankruptcy Code provides an exception to discharge for debts:

> to a spouse, former spouse, or child of the debtor, for alimony to, maintenance for, or support of such spouse or child, in connection with a separation agreement, divorce decree or other order of a court of record, determination in accord with state or territorial law by a governmental unit, or property settlement agreement, but not to the extent that: (A) such debt is assigned to another entity, voluntarily, by operation of law, or otherwise . . . or (B) such debt includes a liability designated as alimony, maintenance, or support, unless such liability is actually in the nature of alimony, maintenance, or support.

11 U.S.C. § 523(a)(5) (1988). This section "represents an attempt by Congress to balance the competing policy considerations of providing the debtor with a fresh start and of not allowing a debtor to neglect his divorce obligations to his former spouse and children." James H. Gold, *The Dischargeability of Divorce Obligations Under the Bankruptcy Code: Five Faulty Premises in the Application of Section 523(a)(5)*, 39 CASE W. RES. L. REV. 455, 457 (1988–1989).

[3] Section 524 of the Bankruptcy Code releases the debtor from further liability on a discharged debt and prohibits the creditor from attempting to enforce the debt. 11 U.S.C. § 524. *See* Sheryl L. Scheible, *Bankruptcy and the Modification of Support: Fresh Start, Head Start, or False Start?*, 69 N.C. L. REV. 577, 580 (1991) [hereinafter Scheible, *Fresh Start*]. Classification of divorce-related obligations is important in other bankruptcy contexts as well. For example, alimony, maintenance, and support payments are exempt property under 11 U.S.C. § 522(d)(10)(D), and the automatic stay of 11 U.S.C. § 362 does not affect the collection of these payments. Sheryl L. Scheible, *Defining "Support" Under Bankruptcy Law: Revitalization of the "Necessaries" Doctrine*, 41 VAND. L. REV. 1, 29 n.167 (1988) [hereinafter Scheible, *Defining Support*].

distributions of marital property—represented the primary means of alleviating financial need and achieving economic equity at the time of divorce.

Recent developments in family law have vitiated both of these assumptions. The widespread adoption of equitable distribution as a means of allocating property interests at the time of divorce has eliminated whatever conceptual distinctions once existed between support awards and property divisions. The advent of equitable distribution has also resulted in property division replacing support as the preferred means of allocating marital gains and losses. The expansion of the definition of marital property to include such intangible assets as pensions and professional goodwill has further blurred both the formal and the functional distinctions between property division and spousal support.

These changes in marital property law have been paralleled by a fundamental rethinking of the nature and functions of alimony, more commonly referred to today as maintenance or spousal support.[4] This rethinking has deemphasized the role of alimony as a status-based obligation designed to alleviate future need and has emphasized instead its compensatory and restitutionary functions—functions that have traditionally been associated not with alimony, but with the division of marital property.

As a result of these developments, the Bankruptcy Code's distinction between nondischargeable support awards and dischargeable property distributions has become untenable. Moreover, because property division has replaced support as the preferred means of adjusting the spouses' financial relationship, a bankruptcy debtor's ability to discharge divorce-related property debts undermines central policy goals associated with modern divorce reform. In particular, permitting discharge of divorce-related property obligations compromises the certainty and finality of divorce settlements and undermines the partnership notions that lie at the heart of equitable distribution schemes. Additionally, because men make up the overwhelming majority of debtors who seek to discharge divorce obligations,

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[4] *See, e.g.*, UNIF. MARRIAGE & DIVORCE ACT § 308, 9A U.L.A. 147 (1987) (referring to "maintenance"). This Article will use the terms alimony, maintenance, and spousal support interchangeably. This interchangeability is consistent with the language of § 523(a) of the Bankruptcy Code. *See supra* note 2.

the current dischargeability rules contribute to the already disparate economic effect of divorce on women.[5]

The Article will therefore argue that the Bankruptcy Code should abandon its attempt to distinguish between nondischargeable spousal support awards and dischargeable property divisions and that Congress should amend the Code to exempt from discharge in bankruptcy *all* financial obligations to or for the benefit of a debtor's ex-spouse or children, assumed or imposed in connection with a divorce or marital separation.[6]

The Article will proceed as follows. Part I will trace the history of the Bankruptcy Code's marital support exemption. Part I.A will argue that the Supreme Court's initial recognition of the nondischargeability of marital debts was broad enough to encompass divorce-related property obligations as well as spousal support awards. Parts I.B and I.C will contend that Congress erred in the late 1970s by rejecting the recommendation of the National Commission on Bankruptcy that all divorce-related property settlements be made nondischargeable in bankruptcy. Part I.D will highlight the doctrinal confusion engendered by Congress's insistence on preserving the support/property distinction.

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[5] *See* Gold, *supra* note 2, at 457 n.8 ("In the overwhelming majority of cases arising under § 523(a)(5), the bankruptcy debtor is a male who is seeking to discharge divorce obligations to his former wife."); William Reppy, *Discharge in Bankruptcy of Awards of Money or Property at Divorce: Analyzing the Risk and Some Steps to Avoid It*, 15 COMMUNITY PROP. J. 1, 1 & n.1 (1988) (husband was debtor in all but two cases read by author while researching article). A plethora of recent empirical studies establish the disparate economic effects of divorce on women and the children in their custody. *See, e.g.*, LENORE WEITZMAN, THE DIVORCE REVOLUTION: THE UNEXPECTED SOCIAL AND ECONOMIC CONSEQUENCES FOR WOMEN AND CHILDREN IN AMERICA (1985); Rosalyn B. Bell, *Alimony and the Financially Dependent Spouse in Montgomery County, Maryland*, 22 FAM. L.Q. 225, 284 (1988); Robert E. McGraw et al., *A Case Study in Divorce Law Reform and Its Aftermath*, 20 J. FAM. L. 443 (1981–1982); James B. McLindon, *Separate but Unequal: The Economic Disaster of Divorce for Women and Children*, 21 FAM. L.Q. 351 (1987); Barbara R. Rowe & Jean M. Lowen, *The Economics of Divorce and Remarriage: The Rural Utah Families*, 16 J. CONTEMP. L. 301 (1990); Barbara R. Rowe & Alice Mills Morrow, *The Economic Consequences of Divorce in Oregon After 10 or More Years of Marriage*, 24 WILLAMETTE L. REV. 463 (1989); Charles E. Welch & Sharon Price-Bonham, *A Decade of No-fault Revisited: California, Georgia, and Washington*, 45 J. MARRIAGE & FAM. 411 (1983); Heather R. Wishik, *Economics of Divorce: An Exploratory Study*, 20 FAM. L.Q. 79 (1986). While critics have questioned the methodology of some of these studies, their overall conclusion—that divorce has a disproportionately negative economic effect on women—remains undisputed. *See, e.g.*, Stephen D. Sugarman, *Dividing Financial Interests on Divorce*, *in* DIVORCE REFORM AT THE CROSSROADS 130 (Stephen Sugarman & Herma Hill Kay eds., 1990).

[6] *See infra* part IV. The proposed amendment would also preserve the nondischargeability of all court-ordered child support obligations. At least one commentator has recently suggested in passing that Congress should eliminate the support/property distinction from the Bankruptcy Code. *See* Scheible, *Fresh Start*, *supra* note 3, at 637.

Part II of the Article will focus on the family law developments that contravene the Bankruptcy Code's support/property distinction. It will show how recent changes in the law and theory governing financial allocations at the time of divorce have enhanced the importance of property obligations and have eliminated both the conceptual and the practical distinctions between spousal support and property division.

Part III will discuss the practical difficulties caused by the support/property division. Parts III.A and III.B will focus on the procedural obstacles facing a divorce obligee during and after an obligor's bankruptcy proceedings. Part III.C will argue that the specter of future bankruptcy often taints divorce negotiations and that the Bankruptcy Code wrongfully allows federal bankruptcy courts to supplant state courts as the ultimate arbiter of the financial arrangement that should follow the dissolution of a marriage.

Finally, Part IV of the Article will articulate and defend a proposed amendment to the Bankruptcy Code that would eliminate the support/property distinction and would preclude a debtor from discharging in bankruptcy any obligations to, or for the benefit of, a former spouse or child incurred in connection with divorce. This Part will demonstrate that such an amendment is necessary to effect important family law goals and is consistent with the "fresh start" policy of bankruptcy law.

I. The History of the Marital Support Exemption

A. *The Supreme Court's Early Recognition of the Nondischargeability of Marital Obligations*

The nondischargeabililty in bankruptcy of marital support obligations is judicial, rather than statutory, in origin. In the 1901 case of *Audubon v. Shufeldt*,[7] the Supreme Court considered whether a debtor in bankruptcy could discharge alimony arrearages of $800 owed to his former wife. The Bankruptcy Act in effect at the time[8] provided for the discharge of "all . . . debts which are provable in bankruptcy, except such as are excepted

[7] 181 U.S. 575 (1901).

[8] Bankruptcy Act, ch. 541, 30 Stat. 544 (1898) (repealed 1978).

by this Act."[9] Included among such provable debts were fixed liabilities evidenced by a judgment or an instrument in writing and debts "founded upon a contract, expressed or implied."[10] The Act contained no exceptions for alimony or other financial obligations arising out of marriage or divorce.

Despite the lack of such a statutory exception, the Supreme Court ruled that the alimony arrearages were not dischargeable. The Court based its ruling on the distinction between contractually-assumed commercial obligations and legal obligations arising out of the marriage relationship. Specifically, the Court reasoned that

> [a]limony does not arise from any business transaction, but from the relation of marriage. It is not founded on contract, express or implied, but on the natural and legal duty of the husband to support the wife. The general obligation to support is made specific by the decree of the court of appropriate jurisdiction.[11]

Thus, the Court's ruling on nondischargeability rested not on any purported distinction between "alimony" and other divorce-related obligations, but rather on factors that distinguish both alimony and divorce-related property awards from obligations arising out of ordinary commercial transactions.

The Supreme Court underscored this reasoning three years later in *Wetmore v. Markoe*.[12] At issue in *Wetmore* was the dischargeability in bankruptcy of a divorced husband's non-modifiable obligation to pay his ex-wife the sum of $3,000 per year.[13] The Court held that while the absolute nature of this husband's obligation distinguished it from the modifiable alimony awards held nondischargeable in *Audubon* and similar cases, "this fact does not change the essential character of the liability nor determine whether a claim for alimony is in its nature contractual so as to make it a debt."[14] In each instance, the Court reasoned, the obligation "is not a debt that has been put in the form of a judgment, but is rather a legal means of

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[9] *Audubon*, 181 U.S. at 577 (discussing Bankruptcy Act of 1898).

[10] *Id.*

[11] *Id.*

[12] 196 U.S. 68 (1904).

[13] Although the husband's obligation was imposed "as alimony," it was to continue even if the wife remarried. *Id.* at 70. The divorce decree also obligated the husband to pay the wife an additional $1,000 annually for the education and maintenance of each of the couple's three minor children. *Id.* at 68.

[14] *Id.* at 74.

enforcing the obligation of the husband and father to support and maintain his wife and children."[15] And in each instance, the debtor owes this duty, "not because of any contractual obligation, but because of the policy of the law which imposes the obligation."[16]

In other words, according to the Court, what distinguishes divorce-related financial obligations from ordinary commercial liabilities—and what makes divorce obligations nondischargeable in bankruptcy even in the absence of an explicit statutory directive—is that these obligations are legally-imposed incidents of the marriage relationship. They arise not out of voluntary contractual exchanges, but rather by operation of law, as a result of an ongoing personal relationship.

Although the Supreme Court's reasoning in *Audubon* and *Wetmore* could apply with equal force to all financial obligations arising out of marriage, it is undeniable that the Court spoke specifically in terms of alimony and support.[17] This is not surprising, however, given the law governing the economic consequences of marriage and divorce at the time. In particular, at the time the Supreme Court recognized the nondischargeability of marital support obligations, the terms "alimony" and "spousal maintenance" were understood in a much broader sense than we understand them today. Most significantly, those terms were understood to encompass much of what we today associate with the equitable distribution of marital property. To understand why this was so, it is necessary to review briefly the economic position of married women prior to the twentieth century.

In the eighteenth and nineteenth centuries, "when the law of alimony was largely shaped and fixed, [a wife] had no property apart from her husband" and little chance of securing a portion of his property if they separated.[18] At common law, ownership of a woman's personal property vested in her husband by virtue

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[15] *Id.*

[16] *Id.*

[17] *See also* Dunbar v. Dunbar, 190 U.S. 340 (1903) (holding that contract obligating divorced husband to make monthly payments for the support of his ex-wife and children could not be discharged in bankruptcy).

[18] Robert W. Kelso, *The Changing Social Setting of Alimony Law*, 6 LAW & CONTEMP. PROBS. 186, 192–93 (1939); *see also* Chester G. Vernier & John B. Hurlbut, *The Historical Background of Alimony Law and Its Present Statutory Structure*, 6 LAW & CONTEMP. PROBS. 197, 198 (1939) ("The discriminatory common law scheme of marital property rights was in full bloom.").

of the marriage.[19] Any personalty that came into her possession during marriage similarly became her husband's property.[20] Upon divorce, her husband's title, being absolute, continued undisturbed.[21] The rules governing a married woman's real property were somewhat more complex, but no more protective of her interests, either during marriage or in the event of divorce.[22] Nor was even a wage-earning wife likely to acquire assets during marriage since, by law, her husband was entitled to all of her earnings.[23]

Viewed against this background, a wife's entitlement to alimony in the event of a divorce represented more than mere judicial enforcement of the husband's legal duty of support.[24] Alimony also functioned as a means of reallocating property interests—a way of restoring to a virtuous wife at least some of the access to material wealth that she had lost by virtue of her marriage.[25] The Supreme Court in *Audubon* explicitly recognized this "property division" aspect of alimony when it stated—in support of the nondischargeability of alimony obligations—that "[p]ermanent alimony is regarded rather as a portion of the husband's estate to which the wife is equitably entitled, than as strictly a debt."[26]

Turn-of-the-century state domestic relations law also recognized the "property division" function of alimony awards.[27] Di-

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[19] HOMER H. CLARK, JR., THE LAW OF DOMESTIC RELATIONS IN THE UNITED STATES 287 (2d ed. 1988); 2 CHESTER G. VERNIER, AMERICAN FAMILY LAWS § 91, at 169 (1932).

[20] John D. Johnston, *Sex and Property: The Common Law Tradition, the Law School Curriculum, and Developments Toward Equality*, 47 N.Y.U. L. REV. 1033, 1045 (1972).

[21] VERNIER, *supra* note 19, § 91. This was also the rule in regard to her choses in action which the husband had reduced to possession. CLARK, *supra* note 19, at 287.

[22] CLARK, *supra* note 19, at 287; Johnston, *supra* note 20, at 1085.

[23] Johnston, *supra* note 20, at 1046. Married women were also disabled from entering into enforceable contracts, which further inhibited their ability to acquire property. *Id.*; *see also* NORMA BASCH, IN THE EYES OF THE LAW 111–12 (1982) ("Because of the law, the entrepreneurial wives who ran urban boardinghouses, managed farms, and headed businesses functioned as their husbands' agents . . . . For them, the chief business remained marriage, a partnership that entailed the surrender of their legal personalities.").

[24] *See* Vernier & Hurlbut, *supra* note 18, at 199.

[25] *See* Timothy B. Walker, *Spousal Support (Alimony, Maintenance): General Considerations, in* BARRY H. FRANK ET AL., ALIMONY, CHILD SUPPORT AND COUNSEL FEES, AWARD, MODIFICATION & ENFORCEMENT 4-1, -4 to -5 (1990) ("Alimony awards at common law were primarily based on the wife's disabilities as a result of coverture and the lack of meaningful opportunities for women. . . . The wife's need for support was not of primary importance.").

[26] Audubon v. Shufeldt, 181 U.S. 575, 578 (1901); *cf.* Orr v. Orr, 440 U.S. 268, 279 n.9 (1979) (discussing argument that husband's duty of support was designed to compensate wives for the discrimination they suffered at the hands of the common law).

[27] *See* Wilson v. Hinman, 75 N.E. 236, 237 (N.Y. 1905) (noting that some states

vorce statutes in a number of states explicitly provided that a court could award a wife, *as alimony*, a portion of her husband's real or personal property.[28] Courts and commentators also noted that while a divorcing husband could not be forced to disgorge assets acquired from his wife by virtue of marriage, the value of such assets should be taken into account in fixing the amount of alimony to which the wife was entitled.[29] The common practice of capping alimony awards at one-third of the husband's estate also reflected property principles; this one-third figure corresponded to the interest that a widow could claim in her husband's lands by virtue of her dower rights.[30]

The passage in the mid- to late 1800s of the married women's property acts ameliorated somewhat the "property-less" status of married women. These statutes, however, did little to alter the relative legal and economic positions of husbands and wives in the event of a divorce. As an initial matter, many of the early statutes left undisturbed a husband's right to his wife's earnings.[31] Other statutes appeared more expansive but were interpreted restrictively by the courts.[32] More fundamentally, even

characterize alimony awarded upon divorce "as a decree settling the property rights of the parties and as a distribution of the assets of the quasipartnership hitherto existing between them"). This view of alimony persisted in a few jurisdictions as late as the mid-1970s. *See, e.g.*, Shula v. Shula, 132 N.E.2d 612, 614 (Ind. 1956) ("Alimony is awarded in Indiana for the purpose of making a present and complete settlement of the property rights of the parties. . . . The primary factor in fixing the alimony is the existing property of the parties."); Wellington v. Wellington, 304 N.E.2d 347, 353 (Ind. App. 1973) ("Alimony serves a dual purpose—a method to aid in the equitable distribution of property and a method to provide continued maintenance or support if deemed appropriate."); Martin A. Rosen, Note, *Indiana's Alimony Confusion*, 45 IND. L.J. 595, 601–03 (1970).

[28] VERNIER, *supra* note 19, § 99 at 237, § 104 at 261, § 107 at 285–90 (discussing statutes); *see also* Annotation, *Propriety of Direction that Specific Property of Husband Be Transferred to Wife as Alimony, or in Lieu of, or in Addition to, Alimony*, 133 A.L.R. 860 (1941).

[29] *See, e.g.*, Smith v. Smith, 161 Eng. Rep. 1130 (1814); Cooke v. Cooke, 161 Eng. Rep. 1072 (1812); Vernier & Hurlbut, *supra* note 18, at 199. By the early 20th century, statutes in a number of jurisdictions allowed courts, in certain circumstances, to grant a divorcing wife some interest in her husband's real or personal property. *See* VERNIER, *supra* note 19, §§ 99–100.

[30] *See* VERNIER, *supra* note 19, § 99 (discussing statutes).

[31] *See* BASCH, *supra* note 23, at 158–59 (discussing 1948 New York statute); Johnston, *supra* note 20, at 1067 - 68 (discussing early Connecticut statutes). In at least one state (Georgia), a husband retained control over his wife's earnings until 1943. *See id.* at 1070 n.156.

[32] *See* BASCH, *supra* note 23, at 200–23 (arguing that restrictive judicial interpretations of New York's married women's property statutes "diminished the legal status of the women of New York for decades to come and represented a lost opportunity in the cause of women's rights"); LEO KANOWITZ, WOMEN AND THE LAW: THE UNFINISHED REVOLUTION 35–41, 59–75, 93–99 (1969); ELIZABETH B. WARBASSE, THE CHANGING LEGAL RIGHTS OF MARRIED WOMEN 1800-1861, at 237–44 (1987); Johnston, *supra* note

the most expansive married women's legislation did not abolish a husband's common law right to his wife's unpaid domestic services, nor a wife's obligation to provide those services.[33] Nor did the married women's property acts increase women's access to employment outside the home. Thus, while statutory developments in the nineteenth century removed some of the formal bars to married women's ownership of property, they did not change the legal or social incidents of marriage that kept most wives from acquiring material wealth.

Moreover, and perhaps ironically, passage of the married women's property acts coincided with the rise of the "cult of domesticity" and the accompanying ideology of separate spheres, which posited that a woman's proper place was in the home, performing unpaid domestic labor, rather than in the workplace accumulating material wealth.[34] The influence of this ideology on the structure of middle- and upper-class marriages further reduced the effect of the married women's property acts on the relative legal and economic positions of divorcing men and women. Women, by virtue of their marriage, continued to sacrifice their ability to hold and accumulate property in return for the right to their husband's financial support.[35]

20, at 1069–70 ("It is clear that a characteristic pattern of restrictive judicial interpretations of this legislation complicated the process and retarded the rate of change.").

[33] *Cf.* 3 CHESTER G. VERNIER, AMERICAN FAMILY LAWS § 173, at 195 (1935); Johnston, *supra* note 20, at 1066, 1071–72. Johnston quotes a turn-of-the-century judicial interpretation of married women's property acts. The court concluded that the married women's property acts did not deprive

> the husband of his common-law right to avail himself of a profit or benefit from his wife's services. The law has never recognized the wife's right to compensation from her husband on account of the peculiar nature of her services for him whether done in or outside the household. While he may not, as a matter of right, require her services outside of the household, yet such services as she does render him, whether within or without the strict line of her duty, belong to him.

Id. at 1066 (quoting Porter v. Dunn, 131 N.Y. 314 (1892), *quoted in* WILLIAM BULLOCK, A TREATISE ON THE LAW OF HUSBAND AND WIFE IN THE STATE OF NEW YORK, INCLUDING CHAPTERS ON DIVORCE AND DOWER § 146 (1897)).

[34] Indeed, a number of those who advocated passage of the married women's property acts—including some female reformers—sought only to improve women's subordinate status within the domestic sphere, not to enhance women's opportunities in the more public arenas of work or politics. *See* BASCH, *supra* note 23, at 163–64, 228. Similarly, many supporters of married women's property rights were opposed to women's suffrage. *Id.* at 189, 196–97.

[35] Historical evidence indicates that throughout the 19th century, 95% of white women did not work outside their homes during marriage. *See id.* at 164–65 (quoting Daniel S. Smith, *Family Limitation, Sexual Control and Domestic Feminism in Victorian America*, *in* CLIO'S CONSCIOUSNESS RAISED 120 (Mary S. Hartman & Lois Banner eds., 1974)). While the percentage of black women who worked during marriage was higher, these women were excluded from most factory and office jobs and were segregated into

Thus, the Supreme Court's 1901 pronouncement that marital support obligations were not dischargeable in bankruptcy took place against a legal and economic landscape that perpetuated, to a significant extent, the "property-less" status of married women.[36] In particular, the legal and economic incidents of marriage continued to deprive divorcing women of access to material wealth. The concept of alimony continued to be understood expansively, encompassing the reallocation of property interests between husbands and wives as well as the enforcement of husbands' common law duty of support.

B. *Codification and Early Interpretation of the Nondischargeability of Marital Debts*

Congress codified the nondischargeability of marital support obligations in 1903 when it amended section 17(a) of the Bankruptcy Act to bar the discharge of debts that "are liabilities . . . for alimony due or to become due, or for maintenance or support of wife or child."[37] This section of the Act remained essentially unchanged for seventy-five years.

Prior to 1970, only a small number of reported cases addressed the dischargeability of particular divorce obligations under section 17(a) of the Bankruptcy Act.[38] In part, this paucity of case

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poorly paid domestic employment. See Nancy Dowd, *Work and Family: Restructuring the Workplace*, 32 ARIZ. L. REV. 432, 435–36 (1990).

[36] *See* BASCH, *supra* note 23, at 229–30 ("With equity as a model, the rights granted to nineteenth-century wives were a far cry from the rights that underpinned the United States Constitution. The married women's property acts did not grant wives the same right to property and its protection that had been synonymous with individual liberty in the eighteenth century."); Richard W. Bartke & Lori A. Zurvalec, *The Low, Middle and High Road to Marital Property Reform in Common Law Jurisdictions*, 7 COMMUNITY PROP. J. 200, 201–03 (1980) ("Since in those times most women were only working in the home or on the family farm, receiving no compensation, and having few expectations of gifts or inheritances, the reforms did nothing for them and still left them propertyless.").

[37] Act of Feb. 5, 1903, ch. 487, § 17, 32 Stat. 797, 798 (amending Bankruptcy Act of 1898, ch. 541, § 17, 30 Stat. 544, 559) (repealed 1979).

[38] The author's search of relevant case digests, secondary sources, and computer databases found 36 cases decided between 1917 and 1969 that discussed whether a particular divorce obligation constituted a nondischargeable support obligation or a dischargeable property debt under § 17(a) of the Bankruptcy Act. A handful of other cases addressed the related issues of the dischargeability of a husband's liability for his ex-wife's divorce expenses, *see, e.g.*, Smith v. Smith, 7 F. Supp. 490 (W.D.N.Y. 1934), and the dischargeability of alimony obligations that had been assigned to third parties. *See* Blackstock v. Blackstock, 265 F. 249 (8th Cir. 1920). For secondary sources discussing these cases, see G. Stanley Joslin, *Bankruptcy from a Family Perspective*, 9 VAND. L. REV. 789, 797–800 (1956); Pierre R. Loiseaux, *Domestic Obligations in Bankruptcy*, 41 N.C. L. REV. 27, 31–38 (1962); Note, *California Divorce Agreements—*

law was a function of the relative infrequency of divorce. It also reflected the relative unimportance of property division (as opposed to alimony or spousal maintenance) as a means of adjusting the financial rights and responsibilities of divorcing spouses.[39] Moreover, even where property division played a significant role in a divorce, the division tended to be accomplished in-kind or by an immediate transfer of funds, rather than by the creation of an ongoing financial obligation that an obligor might later seek to discharge in bankruptcy.[40]

During the 1970s, the divorce rate increased substantially across the country, and the allocation of property interests acquired during marriage became a far more important aspect of many divorce decrees and settlements.[41] At the same time, state law definitions of marital property expanded to include intangible assets such as pensions and other forms of deferred compensation.[42] These changes were paralleled in the bankruptcy context by an increasing amount of litigation over the dischargeability of particular divorce obligations under section 17(a) of the Bankruptcy Act. In particular, courts were increasingly asked to determine whether a particular financial obligation arising out of a divorce constituted a dischargeable spousal support award or a nondischargeable property debt.[43]

Alimony or Property Settlement, 2 STAN. L. REV. 731 (1950); W. R. Habeeb, Annotation, *Obligation Under Property Settlement Agreement Between Spouses as Dischargeable in Bankruptcy*, 74 A.L.R.2D 758 (1960); Annotation, *Construction and Application of Provision of Bankruptcy Acts Excepting Debts for Maintenance or Support of Wife or Child from Discharge*, 103 A.L.R. 722 (1936).

[39] Property division upon divorce played a more important role in the eight community property jurisdictions than in the substantial majority of American states that followed common law property principles. *See generally* JOAN M. KRAUSKOPF, CASES ON PROPERTY DIVISION AT MARRIAGE DISSOLUTION 1–13 (1984). It is not surprising, therefore, that more than a third of the pre-1970 cases discussing the dischargeability of support versus property obligations arose in community property jurisdictions.

[40] *See infra* notes 68–101 and accompanying text (illustrating distinctions between support and property obligations).

[41] Between 1970 and 1981, the divorce rate in the United States increased from 3.5 per 1000 total population to 5.3 per 1000 total population. U.S. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, STATISTICAL ABSTRACT OF THE U.S. 86 tbl. 128 (11th ed. 1991). During that same time period, the divorce rate for married women age 15 or older increased from approximately 14.9 per 1000 to approximately 22.6 per 1000. *See* U.S. Dep't of Health & Human Serv., MONTHLY VITAL STATISTICS REP., Sept. 25, 1986, at 1–2, 5 fig.1.

[42] *See infra* notes 137–148 and accompanying text (discussing the expanded definition of marital property).

[43] *See generally* Mary C. Swann, *Dischargeability of Domestic Obligations in Bankruptcy*, 43 TENN. L. REV. 231 (1976); Note, *Dissolution of Marriage and the Bankruptcy Act of 1973: "Fresh Start" Forgotten*, 52 IND. L.J. 469 (1977) [hereinafter Note, *Fresh Start Forgotten*]; Note, *The Effect of the Indiana Divorce Law on the Application of Section 17(a)(7) of the Bankruptcy Act*, 12 IND. L. REV. 379 (1979) (discussing relationship between dischargeability and state divorce law).

The resulting decisions were confusing and chaotic. As one scholar has explained, "[c]ourts developed a confused and often contradictory body of case law partly because of their failure to agree as to the underlying source of applicable law."[44] Some courts focused exclusively on the law of the state in which the divorce obligation arose, while others attempted to rely on support principles in general—rather than the law of a particular state—to determine the underlying nature (and hence, the dischargeability) of the disputed obligation.[45] Courts adopting the latter approach still reached inconsistent results because they could not agree on the essential attributes of a support obligation.[46]

C. *The Bankruptcy Act of 1978: An Opportunity Missed*

In 1978, Congress enacted a completely revised Bankruptcy Code. As a prelude to that enactment, Congress in 1970 appointed the Commission on the Bankruptcy Laws of the United States (the "Commission") to conduct a comprehensive review of federal bankruptcy law.[47] The Commission recommended, among other things, that the exemption from discharge for marital support obligations be expanded to include "any liability to a spouse or child for maintenance or support, for alimony due or to become due, *or under a property settlement in connection*

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[44] Scheible, *Defining Support*, *supra* note 3, at 26.

[45] *See id.* at 26–27. *Compare, e.g.*, Nitz v. Nitz, 568 F.2d 148 (10th Cir. 1977) (applying Utah law to determine that ex-husband's divorce decree obligations are in the nature of a property settlement, as opposed to alimony or support, and are therefore dischargeable in bankruptcy); Jones v. Tyson (*In re* Jones), 518 F.2d 678 (9th Cir. 1975) (holding that California law determines whether ex-husband's obligation to pay divorced wife's legal fees was in the nature of support); *and* Waller v. Waller (*In re* Waller), 494 F.2d 447, 448 (6th Cir. 1974) ("The law of Ohio must be resorted to in order to determine what constitutes alimony, maintenance or support.") *with* Nunnally v. Nunnally (*In re* Nunnally), 506 F.2d 1024, 1027 (5th Cir. 1975) (stating that bankruptcy court, in determining dischargeability, is not bound by state law characterization of husband's divorce obligation); Shacter v. Shacter (*In re* Shacter), 467 F. Supp. 64, 66 (D. Md.) ("In determining whether [divorce] obligations are liabilities for support, a court should look to the substance of the obligation and not the labels imposed by state law."), *aff'd*, 610 F.2d 813 (4th Cir. 1979); *and* Usher v. Usher (*In re* Usher), 442 F. Supp. 866 (N.D. Ga. 1977) (holding that characterization of payments as alimony in divorce decree is not determinative of whether obligation is nondischargeable alimony or property settlement).

[46] Scheible, *Defining Support*, *supra* note 3, at 27.

[47] Act of July 24, 1970, Pub. L. No. 91-354, 84 Stat. 468.

with a separation agreement or divorce decree."[48] The Commission explained that the proposed expansion recognized that "obligations to provide for family dependents in the future may take the form of either a duty to make periodic payments based on need or an obligation to pay a settlement based on the debtor's present or anticipated wealth. The choice of form frequently turned on tax considerations or other factors not directly related to the duty to provide support."[49] Congressional hearings on the Commission's proposal also suggested that the proposed expansion would benefit divorced spouses and children by making it unnecessary to relitigate in a bankruptcy proceeding a previously settled divorce award.[50]

The National Conference of Bankruptcy Judges opposed the Commission's recommendation.[51] In testimony before Congress, Judge Joe Lee, a representative of the Conference, argued that the Commission's proposal would have a "disastrous effect" on divorcing husbands and would impede the objective of rehabilitating debtors.[52] Judge Lee also claimed that precluding husbands from discharging divorce-related property obligations would be "counterproductive," since it would inhibit their ability to comply with court-ordered alimony and child support.[53]

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[48] COMM'N ON THE BANKRUPTCY LAWS OF THE U.S., REPORT OF THE COMM'N ON THE BANKRUPTCY LAWS OF THE U.S., H.R. DOC. NO. 137, 93d Cong., 1st Sess., pt. 2 136 (1973) (emphasis added) [hereinafter COMMISSION REPORT]. The Commission's 1973 report to Congress consisted of two parts. Part I contained the Commission's analysis and evaluation of the existing bankruptcy system, along with its recommendations for change. Part II consisted of a proposed statute, optimistically entitled the Bankruptcy Act of 1973, designed to implement the Commission's recommendations. *See id.* For the full text of the Commission Report, see WILLIAM M. COLLIER ET AL., 2 COLLIER ON BANKRUPTCY app. at I-1 (Lawrence P. King et al. eds., 15th ed. 1992).

[49] COMMISSION REPORT, *supra* note 48, at 139.

[50] *Bankruptcy Law Revision: Hearings on H.R. 31 & 32 Before the Subcomm. on Civil & Constitutional Rights of the House Comm. on the Judiciary*, 94th Cong., 2d Sess. 1288–89 (1976) [hereinafter *1976 Hearings*] (remarks of Representative Robert F. Drinan (D-Mass.)).

[51] The National Conference of Bankruptcy Judges disagreed with major aspects of the draft legislation submitted to Congress by the Commission. The bankruptcy judges therefore drafted and submitted an alternative proposal. Both proposals were introduced in the 93d and 94th Congresses, and joint hearings were held on the two draft bills between May 1975 and May 1976. *See* HOUSE COMM. ON THE JUDICIARY, BANKRUPTCY LAW REVISION, H.R. REP. NO. 595, 95th Cong., 1st Sess. 2 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5964.

[52] *1976 Hearings*, *supra* note 50, at 1281, 1288 (oral and prepared statement of Judge Lee). Judge Lee also gave substantially similar testimony in opposition to a proposed Senate bill which adopted the Commission's recommendation to extend nondischargeability to divorce-related property settlements. *See Bankruptcy Act of 1978: Hearings on S. 2266 and H.R. 8200 Before the Subcomm. on Improvements in Judicial Machinery of the Comm. on the Judiciary*, 95th Cong., 1st Sess. 685–86 [hereinafter *1977 Hearings*] (oral and prepared statement of Judge Lee).

[53] *1977 Hearings* at 686 (oral and prepared statement of Judge Lee); *1976 Hearings*,

The bankruptcy judges were particularly concerned that husbands be permitted to discharge obligations, assumed upon divorce, to pay joint marital debts or to hold their wives harmless on marital obligations. In a supplemental submission to the House Judiciary Committee, Judge Lee argued that husbands are often unrepresented in divorce proceedings and may agree to assume joint marital debts without fully understanding the legal consequences of such an agreement.[54] While conceding that allowing a husband to discharge his divorce-related assumption of joint marital debts might result in the wife becoming solely liable for the debts, he suggested that the "best solution" to this problem would be for the wife to declare bankruptcy as well, rather than requiring her ex-husband to honor his obligations arising out of the divorce decree.[55] Judge Lee also proffered another possible solution: the revised Bankruptcy Code could include a definition of "alimony" which excluded property settlements, thereby limiting nondischargeable marital debts and assuring bankrupt husbands a fresh start.[56]

The Bankruptcy Code eventually passed by Congress adopted in large part the position of the bankruptcy judges. It rejected the Commission on the Bankruptcy Laws' proposal to expand the marital discharge exemption to encompass divorce-related property settlements. Consistent with Judge Lee's suggestions, Congress also made clear that a state court's designation of a divorce-related obligation as "alimony" or "maintenance" would not be sufficient to establish its nondischargeability in bankruptcy. Rather, the bankruptcy court would be required to determine whether the particular obligation was "actually in the nature of alimony, maintenance, or support."[57] And, in making that determination, federal bankruptcy law, not state domestic relations law, was to govern.[58]

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supra note 50, at 1308 (supplemental statement of Judge Lee). For an extended discussion of this testimony, see J. Joseph Cohen, Note, *Congressional Intent in Excepting Alimony, Maintenance, and Support from Discharge in Bankruptcy*, 21 J. FAM. L. 525, 534–36, 539 n.103 (1983).

[54] *1976 Hearings*, *supra* note 50, at 1308 (supplemental statement of Judge Lee); *see also 1977 Hearings*, *supra* note 52, at 688 (statement of Judge Lee) ("The language of the Senate Bill will make it possible for lawyers to subvert the alimony exception to discharge simply by providing in the property settlement agreement that certain debts shall be paid by the husband. In most instances the husband will not be able to make alimony or child maintenance payments and also pay all the debts of the parties.").

[55] *1976 Hearings*, *supra* note 50, at 1288 (oral statement of Judge Lee).

[56] *Id.* at 1310 (supplemental statement of Judge Lee).

[57] 11 U.S.C. § 523(a)(5) (1988).

[58] SENATE COMM. ON THE JUDICIARY, BANKRUPTCY REFORM ACT OF 1978, S. REP.

The arguments successfully propounded by the National Conference of Bankruptcy Judges at best reflect a profound misjudgment about the economic realities of divorce. Today, as in the 1970s, only a small minority of divorcing husbands are required to pay alimony or spousal support.[59] Even fewer divorcing husbands are ordered *both* to support their former wives and children *and* to assume substantial marital debt—the scenario upon which Judge Lee's counter-productivity argument depends. To the contrary, in an increasing number of divorces, the property obligations that a divorcing husband seeks to discharge in bankruptcy represent his ex-wife's only significant financial entitlement arising out of the divorce.

Moreover, a plethora of empirical studies establish that it is divorcing wives, and not their husbands, who incur the greatest economic hardship as a result of marital dissolution. Lenore Weitzman's pioneering study of divorcing couples in California revealed that, within a year after divorce, women on average experience a seventy-three percent decline in their per capita standard of living while men experience a forty-two percent improvement.[60] Similar studies conducted in states across the country confirm Weitzman's basic conclusions.[61] Judge Lee's claim that divorcing husbands, deprived of competent legal advice, routinely incur financial obligations that they can neither understand nor afford is not supported by the available empirical evidence.

Recent studies also reveal that many female heads of household are precariously close to bankruptcy themselves. For example, a recent comprehensive study of consumer bankruptcy found that single women who file for bankruptcy are much more

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No. 989, 95th Cong., 2d Sess. 79 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787. This report states: "What constitutes alimony, maintenance or support will be determined under the bankruptcy law, not State law." *Id.* at 5865. This language was intended to overrule cases such as Waller v. Waller (*In re* Waller), 494 F.2d 447 (6th Cir. 1974), in which the court held that a husband's divorce-incorporated agreement to pay and indemnify and hold his wife harmless from all existing marital debts constituted alimony under state law and was therefore not dischargeable in bankruptcy. *Id.*

[59] As of spring 1986, less than 15% of ever-divorced or currently separated women in the United States were awarded (or had an agreement to receive) alimony. Only 12.4% of women divorced between 1980 and 1985 were awarded alimony. BUREAU OF THE CENSUS, U.S. DEP'T OF COMMERCE, SERIES P-23, No. 154, CHILD SUPPORT AND ALIMONY: 1985 16 tbl. K (1989). In 1977, approximately 16.5% of divorcing women in California were awarded alimony. WEITZMAN, *supra* note 5, at 169. Moreover, most alimony and spousal support awards today terminate within a few years after divorce. *See* notes 151–157 and accompanying text.

[60] WEITZMAN, *supra* note 5, at 338–39.

[61] *See supra* note 5 (studies cited).

similar economically to their counterparts in the general population than are men who file for bankruptcy, either alone or with their wives.[62] In particular, while men who file for bankruptcy have substantially lower earnings and income than men in the general population, the earnings of women heads of household in or out of bankruptcy were statistically indistinguishable.[63] Women in the general population had higher total incomes than women in bankruptcy, but only because the former group received approximately thirty percent of their total income from non-wage sources, including alimony and other divorce awards.[64] The authors conclude that, for many women, the receipt of such supplemental income may well represent the difference between staying out of bankruptcy and being forced into it.[65]

In light of these economic realities, the bankruptcy judges' overriding concern with mitigating the alleged financial burdens faced by divorcing husbands seems misplaced, to say the least. Divorce is likely to be financially difficult for all family members, but allowing a debtor husband to avoid his divorce-related obligations at the expense of his ex-wife and children only exacerbates an already disparate economic situation. Equally disturbing is Judge Lee's suggestion that the "preferred solution" for any unfairness to women created by the dischargeability of particular divorce-related obligations is for them to declare bankruptcy as well, and for both ex-spouses to reap the benefits of a fresh financial start. While the precarious financial circumstances faced by many divorced women indicates that Judge Lee's "dual bankruptcy" scenario is a realistic one, advocating this as a "preferred solution" ignores entirely the disparities in income and earning power that the former husband and wife are likely to face after bankruptcy has wiped their respective slates clean.

More generally, both the position of the bankruptcy judges and congressional endorsement of that position evince a disturbing disregard for the needs and interests of divorced women. Indeed, after Representative Robert F. Drinan (D-Mass.) pressed Judge Lee on the potential unfairness to wives of allowing husbands to discharge their divorce-related property obli-

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[62] THERESA A. SULLIVAN ET AL., AS WE FORGIVE OUR DEBTORS 151–56 (1989).
[63] *Id.* at 156.
[64] *Id.*
[65] *Id.*

gations, another representative interrupted the proceedings by asking Judge Lee to forgive Father Drinan for being "really . . . stuck on his divorce."[66] General laughter followed this remark.[67]

D. *The Support/Property Distinction in Practice: Doctrinal Confusion and Federal Encroachment*

Congress's 1978 decision to preserve the statutory distinction between nondischargeable support awards and dischargeable divisions of marital property exacerbated the confusion in an already discordant body of case law. Although Congress made clear that federal law, rather than state law, was to govern the dischargeability determination, neither Congress nor the federal courts have developed clear or uniform standards for determining when a particular divorce obligation qualifies as "alimony, maintenance, or support."[68] Instead, "confusion, disagreement, and controversy over the appropriate method of determining the nature of a divorce-related debt, and thereby its status for the purpose of discharge, has continued."[69] Courts and commentators disagree, for example, on the continued relevance of state domestic relations law to the dischargeability inquiry.[70] They also differ on the significance of the characterization of the

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[66] *1976 Hearings*, note 50, at 1290.

[67] *Id.*

[68] *See* Sandra D. Freeburger & Claude Bowles, *What the Divorce Court Giveth, Bankruptcy Court Taketh Away: Review of the Dischargeability of Marital Support Obligations*, 24 J. FAM. L. 587, 600 (1985–86) ("Despite this long history of judicial interpretation [of § 523(a)], no single uniform federal standard has yet emerged from the case law to define alimony, maintenance or support."); Gold, *supra* note 2, at 456 ("Section 523(a)(5) is also a frequently litigated provision because neither Congress nor the courts have provided clear guidance as to what constitutes alimony, maintenance, or support for purposes of section 523(a)(5)."); Scheible, *Defining Support*, *supra* note 3, at 5 ("A tremendous volume of litigation has been generated under section 523(a)(5) largely because of the courts' failure to develop a clear federal standard for determining the nature of these debts."); Comment, *Striking the Mean Between the Goals of Bankruptcy and Divorce*, 7 BANK. DEV. J. 565, 574 (1990) ("The problem is that the current statute has completely failed to effect the development of a *clear and uniform* standard for determining the nature of domestic obligations in the context of the bankruptcy of one of the spouses.").

[69] Scheible, *Defining Support*, *supra* note 3, at 29.

[70] *Compare, e.g.*, Pauley v. Spong (*In re* Spong), 661 F.2d 6 (2d Cir. 1981) (relying heavily on state domestic relations law to conclude that counsel fees awarded in connection with divorce fell within the bankruptcy definition of alimony, maintenance, or support) *with* Boyle v. Donovan, 724 F.2d 681 (8th Cir. 1984) (rejecting argument that divorce-created obligation to pay children's post-majority education expenses must be nondischargeable because state law did not create duty of post-majority support).

obligation in the divorce decree or settlement agreement,[71] and on the propriety of examining the parties' post-divorce financial circumstances in determining whether a disputed award is "in the nature . . . of support."[72] Indeed, one recent law review article identifies five separate approaches that bankruptcy courts currently use to determine whether a disputed divorce obligation is a nondischargeable support award or a dischargeable property debt.[73]

Other bankruptcy commentators contend that most federal courts have adopted some version of an intent test for distinguishing support from property obligations.[74] Under this approach, the relevant inquiry is whether the divorcing parties or the court intended the disputed obligation to provide support for a financially dependent spouse.[75] If so, then the obligation is nondischargeable. Even these commentators concede, however, that bankruptcy courts differ on the propriety and relative significance of a wide range of factors in discerning judicial or party intent.[76] For example, some bankruptcy courts place great weight on the language and structure of the divorce decree or settlement agreement while other courts hold that such factors

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[71] *See* Gold, *supra* note 2, at 468–76; Scheible, *Defining Support*, *supra* note 3, at 30–35.

[72] *See* Gold, *supra* note 2, at 486–92; Scheible, *Fresh Start*, *supra* note 3, at 596–617.

[73] Freeburger & Bowles, *supra* note 68, at 600–13. The five categories are State Law Standards, Factors Test, Intent Tests, Facts and Circumstances Tests, and the *Calhoun* Doctrine. *Cf.* Richard D. Zeisler, *The Effect of Bankruptcy Laws on Marital Dissolutions, Agreements and Property*, *in* FAMILY LAW AND PRACTICE § 44.05[4], at 44-19 (Arnold H. Rutkin ed., 1991) (identifying three overlapping perspectives that courts use as starting points to determine whether a divorce obligation constitutes nondischargable support).

[74] *See, e.g.*, John F. Murphy, *The Dischargeability in Bankruptcy of Debts for Alimony and Property Settlements Arising from Divorce*, 14 PEPP. L. REV. 69, 74 (1986); Scheible, *Fresh Start*, *supra* note 3, at 594; Zeisler, *supra* note 73, § 44.05[4][b] ("Bankruptcy courts most often cast the issue of characterization of family support [obligations] in terms of the intent of the parties or divorce court."); Note, *Bankruptcy and Divorce in Kansas*, 29 WASHBURN L.J. 551, 560 (1990) ("While courts must rely on various tests to resolve the differences between an obligation for support and a property settlement, the most common test is the intent test.").

[75] *See, e.g.*, Yeates v. Yeates (*In re* Yeates), 807 F.2d 874, 878 (10th Cir. 1986); Boyle v. Donovan, 724 F.2d 681, 683 (8th Cir. 1984) (explaining that the critical question in the dischargeability determination is the function that the parties intended the agreement to serve at the time they entered into it); *In re* Coil, 680 F.2d 1170, 1171 (7th Cir. 1982). The relevant intent depends upon the origin of the obligation. Where a divorce obligation is the product of an agreement between the parties, the intent of the parties governs. *See* Freeburger & Bowles, *supra* note 68, at 606–07 n.84. Where the obligation arises from a court decree entered after an adjudicated divorce, the bankruptcy court must determine the intent of the court that imposed the obligation. *Id.*; *see also* Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1109 n.10 (6th Cir. 1983); Helm v. Helm (*In re* Helm), 48 B.R. 215, 221 (W.D. Ky. 1985).

[76] *See* Scheible, *Defining Support*, *supra* note 3, at 29–35.

are not dispositive on the question of intent.[77] Discerning the intent of a disputed divorce obligation is likely to be particularly difficult in the overwhelming number of cases in which the obligation is the product of a negotiated settlement, rather than a contested adjudication. During divorce negotiations, parties (and their attorneys) are likely to be far less interested in the precise legal characterization of their obligations than in the bottom line question of the total financial package for each spouse.[78] "Whether a particular obligation takes the form of a property division or alimony will often be the result of capricious factors such as the amount of marital assets and obligations to be divided and the drafting style of the lawyer preparing the settlement agreement . . . ."[79] Tax considerations, as well, have traditionally played a significant role in determining the legal label attached to a particular divorce obligation.[80] Bankruptcy courts have repeatedly emphasized these difficulties in attempting to discern relevant intent.[81]

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[77] *Compare, e.g., Yeates*, 807 F.2d at 878 (clear, unambiguous language generally controls); Clark v. Clark (*In re* Clark), 113 B.R. 797, 801 (S.D. Ga. 1990) (no further investigation necessary when intent is clear from face of agreement; wife's waiver of alimony precludes classifying as nondischargeable husband's agreement to pay home mortgage); *and* Hoivik-Olson v. Hoivik (*In re* Hoivik), 79 B.R. 401 (Bankr. W.D. Wis. 1987) (ex-husband's obligation to make mortgage payments on marital residence dischargeable because it appeared in a sentence that included the words "complete and final property division") *with Calhoun*, 715 F.2d at 1111 (reversing lower court's holding that clear language of separation agreement controlled dischargeability inquiry); Williams v. Williams (*In re* Williams), 703 F.2d 1055 (8th Cir. 1983) (stating that disputed obligations were within the bankruptcy definition of support even though the original divorce agreement characterized them as a "property settlement" in order to insulate the nondebtor spouse from tax liability); Jenkins v. Jenkins (*In re* Jenkins), 94 B.R. 355, 360 (Bankr. E.D. Pa. 1988); *and* Myers v. Myers (*In re* Myers), 61 B.R. 891, 894 (Bankr. N.D. Ga. 1986).

[78] *See* Graham v. Jenkins (*In re* Jenkins), 32 B.R. 978, 982 (Bankr. S.D. Ohio 1983) ("Few are the cases where either party knows or cares whether [the debt] is alimony, support or [a] division of property. Each is interested only in what each will get or have to pay."); Freeburger & Bowles, *supra* note 68, at 608; Gold, *supra* note 2, at 471; Murphy, *supra* note 74, at 74.

[79] Gold, *supra* note 2, at 471.

[80] *Id.* at 471 n.63. Recent amendments to the Internal Revenue Code have significantly reduced the importance of the property versus alimony label attached to a divorce obligation. *See infra* note 148.

[81] *See, e.g.*, Mencer v. Mencer (*In re* Mencer), 50 B.R. 80 (E.D. Ark. 1985); Helm v. Helm (*In re* Helm), 48 B.R. 215, 221 (W.D. Ky. 1985); Rankin v. Alloway (*In re* Alloway), 37 B.R. 420, 425 (E.D. Pa. 1984) ("Very often the parties have no intent to differentiate between an alimony debt and a property settlement debt and will view both as merely financial obligations arising from the separation or divorce."); *Jenkins*, 32 B.R. at 982 (noting that parties gave no thought to possibility of bankruptcy); Schroeder v. Schroeder (*In re* Schroeder), 25 B.R. 190, 191 (Bankr. N.D. Ill. 1982) ("Unfortunately, attorneys drafting divorce property settlements and judgments do not usually anticipate . . . a subsequent bankruptcy by one of the parties. As a result, questions such as [these] arise time and again in the bankruptcy courts.").

Because of the difficulties of determining intent, many bankruptcy courts have recently shifted their focus to the effect or function of a disputed divorce obligation.[82] Thus, bankruptcy courts now commonly examine the family circumstances at the time of divorce to determine whether the disputed liability was essential to the nondebtor spouse's basic well-being and was reasonable in light of the debtor's ability to pay.[83] If the court finds that the disputed obligation has the effect of providing necessary and reasonable support, then the court is likely to conclude that the award was intended as support and that it therefore survives bankruptcy.[84] If, by contrast, the bankruptcy court finds that the nondebtor spouse can meet her basic needs without relying on the disputed obligation, then the court is likely to conclude that the obligation was not intended to provide support, and that it should therefore be discharged.[85]

As a result of this emphasis on the effect or function of a disputed divorce award, the federal courts' dischargeability inquiry has increasingly come to resemble the examination that state divorce courts typically undertake in order to resolve financial issues at the time a marriage is dissolved. In both contexts, the court is centrally concerned with the obligee-spouse's financial needs and the potential obligor's economic circumstances. In characterizing disputed divorce obligations, bankruptcy courts currently consider both parties' "mental, physical, and emotional health; age; work skills; educational background and opportunities to enhance earning potentials; and the extent of individual assets."[86] To improve the quality of their determinations, Professor Scheible urges bankruptcy courts to consider as well "[t]he length of the parties' marriage" and "the presence of minor children, their unique needs, and the custodial and visitational arrangements made regarding them."[87]

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[82] *See* Scheible, *Fresh Start*, *supra* note 3, at 595; Scheible, *Defining Support*, *supra* note 3, at 32.

[83] Scheible, *Fresh Start*, *supra* note 3, at 595.

[84] *Id.*

[85] *See, e.g.*, Tsanos v. Bell (*In re* Bell), 47 B.R. 284, 287 (Bankr. E.D.N.Y. 1985) (holding that since divorced wife was employed and capable of self-support, debtor's contractual obligation to pay her rent was not in the nature of support and was therefore dischargeable); Altavilla v. Altavilla, 40 B.R. 938, 941 (Bankr. D. Mass. 1984); Bedingfield v. Bedingfield (*In re* Bedingfield), 42 B.R. 641, 649 (Bankr. S.D. Ga. 1983) (holding that debtor's assumption of ex-wife's automobile loan and agreement to pay her law school expenses were insufficiently related to wife's basic needs to avoid discharge).

[86] Scheible, *Defining Support*, *supra* note 3, at 58; *see also* Note, *supra* note 74, at 563–64.

[87] Scheible, *Defining Support*, *supra* note 3, at 58.

This exhaustive list of factors bears an uncanny resemblance to the factors that state courts typically weigh in determining how to allocate financial interests equitably at the time a marriage is dissolved. There, too, the court considers the parties' individual and jointly-accumulated assets, their respective contributions to those assets, and their future needs and economic capabilities.[88] In essence, then, the Bankruptcy Code's current dischargeability inquiry supplants the divorce court's earlier financial determinations and affords the debtor-spouse a second chance to contest the very issues of economic equity and financial need that he either conceded or lost at the time of the divorce.

Bankruptcy law's increased focus on the effect of disputed divorce awards has also persuaded some bankruptcy courts to consider evidence of any changes in the parties' relative economic positions occurring between the divorce and the bankruptcy filing.[89] This allows a debtor to argue that even if a particular divorce obligation originally functioned as support, events occurring since the divorce have deprived the award of its "support" characteristics and therefore rendered it totally or partially dischargeable in bankruptcy.[90]

Such a "changed circumstances" argument is likely to be particularly effective in the bankruptcy context. As one commentator has noted, "[w]hen the debtor's present circumstances are taken into account the scales tip heavily in his favor because

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[88] *See infra* part II.

[89] Although most bankruptcy courts limit their examination of the parties' relative economic positions to circumstances existing at the time of the divorce, a minority of courts consider as well any changes in the parties' financial positions occurring between the divorce and the bankruptcy filing. *See, e.g.*, Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1109, 1110 & n.11 (6th Cir. 1983); Helm v. Helm (*In re* Helm), 48 B.R. 215, 225 (Bankr. W.D. Ky. 1985); *Altavilla*, 40 B.R. at 941. *See generally* Scheible, *Fresh Start, supra* note 3, at 596–617; Zeisler, *supra* note 73, § 44.05[6], at 44-29 to -31.

[90] *See, e.g.*, Forsdick v. Turgeon, 812 F.2d 801, 803 (2d Cir. 1987) (presenting debtor's appeal to changed circumstances). Focusing on the parties' present circumstances could also lead a court to find that an award that was not originally intended to provide support has, because of changed financial circumstances, taken on a support function and is therefore nondischargeable. In practice, however, the structure of the "present circumstances" inquiry precludes this result. Under *Calhoun*, a bankruptcy court must first find that the relevant legal actors intended the disputed debt to create a support obligation. If they did not, the debt is dischargeable regardless of the parties' present needs and financial circumstances. *See Calhoun*, 715 F.2d at 1109; *cf.* Tilley v. Jessee, 789 F.2d 1074, 1076–78 (4th Cir. 1986) (holding that despite wife's demonstrated need for support, she failed to show that both she and her husband intended husband's agreement to pay a lump sum in installments to constitute a support obligation). Only if the parties or the state divorce court intended to create an obligation to provide support should the bankruptcy court go on to consider whether the award has the present effect of providing for an ex-spouse's daily needs. *Calhoun*, 715 F.2d at 1109.

his bankruptcy action itself is persuasive evidence that his financial situation has deteriorated."[91] Focusing on the parties' present financial positions also penalizes an obligee-spouse who has improved her economic position through employment or remarriage.[92] Moreover, it does so in a way not contemplated by the divorce decree, and without resort to established state procedures for the modification of divorce obligations.

Johnson v. Seta[93] illustrates the effect of allowing a bankruptcy court to consider post-divorce circumstances in determining the dischargeability of a divorce obligation.[94] In *Seta*, the parties divorced after a thirteen-year marriage that left the husband with substantially more earning power than the wife.[95] Although the wife received custody of the couple's two children, the divorce decree awarded the marital residence to the husband.[96] In lieu of alimony, the decree ordered the husband to assume a $6,000 second mortgage on the marital residence and to pay the wife an additional $6,000 as her share of the equity in the house.[97] In the husband's subsequent bankruptcy proceeding, filed shortly after the divorce, the bankruptcy court found that neither obligation was in the nature of support, despite the disparity in the spouses' respective earning potential and the absence of an explicit alimony award. The bankruptcy court based its finding on the wife's subsequent remarriage and on its conclusion that the wife's present needs were being "more than adequately" met out of her second husband's income.[98]

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[91] Scheible, *Fresh Start*, *supra* note 3, at 598; *see also* Chedrick v. Chedrick (*In re* Chedrick), 98 B.R. 731, 734 (W.D. Pa. 1989).

[92] *See* Gianakas v. Gianakas (*In re* Gianakas), 917 F.2d 759, 763 (3d Cir. 1990) (rejecting changed circumstances analysis and noting that examination of a former spouse's continued need would "serve essentially as a penalty for a former spouse who may have struggled to gain self-sufficiency"); Sharp v. Hysock (*In re* Hysock), 75 B.R. 113 (Bankr. D. Del. 1987) (citing ex-wife's better-paying post-divorce employment in support of finding that husband's assumption of second mortgage no longer functioned as nondischargeable spousal support); Yeates v. Yeates (*In re* Yeates), 44 B.R. 575, 580–81 (Bankr. D. Utah 1984) (noting that a material improvement in a recipient spouse's financial condition, such as securing a higher-paying job, might render a support award "superfluous, and dischargeable").

[93] 45 B.R. 8 (Bankr. S.D. Ohio 1984).

[94] *Id.* at 9.

[95] *Id.*

[96] *Id.* at 8.

[97] *Id.* at 8–9. The divorce decree ordered the husband to assume and hold the plaintiff harmless on both a first and a second mortgage on the marital residence. This obligation was to be secured by a third mortgage from the husband to the wife. The residence was sold after the husband filed for bankruptcy. The purchase price was sufficient to pay off the first mortgage, but not the second. *Id.* at 9.

[98] *Id.*

A majority of federal appellate courts have refused to consider the parties' post-divorce circumstances in determining the dischargeability of divorce obligations.[99] They reason that a bankruptcy court's consideration of such "changed circumstances" would amount to an improper usurpation of the states' traditional role in modifying domestic relations decrees. As the Second Circuit recently explained: "An inquiry [into alleged changed circumstances] would put federal courts in the position of modifying the matrimonial decrees of state courts, thus interfering with the delicate state systems for dealing with the dissolution of marriages and the difficult and complex results that flow therefrom."[100]

But precisely the same "usurpation" charge applies to virtually *all* dischargeability determinations under the current Bankruptcy Code. That is, a bankruptcy court's application of what one appellate opinion candidly terms "[t]he federal bankruptcy common law of domestic relations" to determine the dischargeability of obligations previously imposed in a state divorce decree necessarily interferes with "the delicate state systems" for handling divorce.[101] This is true regardless of whether the bankruptcy court considers the parties' post-divorce circumstances. The shift from a strict intent test to an inquiry that focuses explicitly on the effect or function of the disputed award highlights the extent of this federal interference: in ascertaining whether a disputed obligation functions as sup-

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[99] *See* Gianakas v. Gianakas (*In re* Gianakas), 917 F.2d 759 (3d Cir. 1990); Sylvester v. Sylvester, 865 F.2d 1164 (10th Cir. 1989) (per curiam); Forsdick v. Turgeon, 812 F.2d 801 (2d Cir. 1987); Draper v. Draper, 790 F.2d 52 (8th Cir. 1986) (per curiam); Harrell v. Sharp (*In re* Harrell), 754 F.2d 902 (11th Cir. 1985).

[100] *Forsdick*, 812 F.2d at 803–04. Commentators are divided on the propriety of such a changed circumstances inquiry. *Compare* Scheible, *Fresh Start*, *supra* note 3, at 635–38 (arguing that bankruptcy courts' application of present circumstances test constitutes improper usurpation of state courts' traditional power to create and modify support obligations; bankruptcy courts should therefore abstain from determining the nature of disputed marital debts and defer to the more appropriate state court forum) *with* Gold, *supra* note 2, at 489–90 (endorsing bankruptcy courts' consideration of parties' present financial circumstances in determining dischargeability of divorce obligations) *and* Michaela M. White, *Strange Bedfellows: The Uneasy Alliance Between Bankruptcy and Family Law*, 17 N.M. L. REV. 1, 34 (1987).

[101] *See* Gold, *supra* note 2, at 489. Indeed, it is arguable that the language of § 523 implicitly supports consideration of the parties' present financial circumstances. Section 523 excepts from discharge a marital obligation only where "such liability *is* actually in the nature of alimony, maintenance, or support." 11 U.S.C. § 523(a)(5)(B) (emphasis added). As one commentator has noted, "[t]he use of the present tense *is* supports *Calhoun's* implicit conclusion that the statute directs discharge of support-related debts unless they are *currently* in the nature of support at the time . . . the bankruptcy petition is filed." Scheible, *Fresh Start*, *supra* note 3, at 610.

port, bankruptcy courts essentially reweigh precisely the same economic and equitable factors that a state court previously considered in determining whether to impose or approve the obligation.

Thus, it is not the inquiry into "changed circumstances" that creates the specter of federal usurpation of the states' traditional domestic relations role—although the debtor's ability to plead "changed circumstances" may increase the likelihood that a particular divorce obligation will be discharged. The problem of federal usurpation stems from the structure of the current Bankruptcy Code. It inheres in the Code's attempt to distinguish—as a matter of federal common law—between divorce obligations that survive bankruptcy because they are "in the nature of . . . support" and divorce obligations that can be extinguished because a federal court determines that they lack the essential characteristics of support, and therefore constitute dischargeable property debts.

E. *Summary*

The foregoing analysis establishes that the Supreme Court's original rationale for exempting marital support obligations from discharge in bankruptcy was broad enough to encompass divorce-related property divisions as well as alimony and support awards. Although Congress's 1903 codification of the exemption referred explicitly to "alimony . . . maintenance or support," this language reflected the "property-less" status of married women and the relative unimportance of property division as a means of adjusting financial interests and obligations at the time of divorce.

As both divorce and property division became more common, bankruptcy courts were called upon with increasing frequency to distinguish between nondischargeable spousal support awards and dischargeable divisions of marital property. These efforts produced a confusing and inconsistent body of case law. Congress in the mid-1970s could have remedied this confusion by expanding the marital discharge exemption to encompass divorce-related property obligations, as well as spousal support awards—a course of action recommended by its own expert commission. Congress rejected the Commission's recommen-

dation because of a serious misjudgment about the economic realities of divorce.

Congress's insistence on preserving the support/property distinction has exacerbated an already confused body of case law. Despite a growing number of cases, the federal courts have failed to develop clear or consistent guidelines for distinguishing nondischargeable support awards from dischargeable property obligations arising out of divorce. Moreover, Congress's directive that divorce obligations be characterized according to federal law, rather than state law, has resulted in increasing federal interference with state domestic relations schemes. These judicial failures are understandable: they reflect the fact that meaningful distinctions no longer exist between support awards and property divisions.

II. Family Law Developments

The shortcomings of the Bankruptcy Code's current approach to divorce obligations are not limited to doctrinal confusion and federal encroachment. The Code's support/property distinction is also fundamentally inconsistent with recent trends in family law. Family law developments over the past fifteen years have eliminated most of the formal distinctions between support and property obligations and have undermined whatever theoretical differences once existed between them.

A. *Traditional Distinctions*

Although alimony and property awards have always been intertwined, it seemed possible, until recently, to draw some coherent distinctions between the two, both conceptually and practically. In concept, alimony was expressly forward-looking: its purpose was to provide for a dependent spouse's future needs, *not* to compensate a spouse for contributions made during marriage.[102] Property awards, by contrast, were oriented

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[102] *See* Clark, *supra* note 19, at 593, 641–42 (identifying the purposes and functions of alimony as the maintenance and support of the spouse and, indirectly, the children of the marriage); Gold, *supra* note 2, at 469 (describing alimony as based on spouse's continuing legal duty to provide for the needs of his former spouse and children after a divorce); Suzanne Reynolds, *The Relationship of Property Division and Alimony: The Division of Property to Address Need*, 56 Fordham L. Rev. 827, 831–32 (1988) (explaining that the dominant justification for alimony in both separate and community property states was to accommodate economic need).

toward the past: their purpose was to unscramble the respective ownership interests of each spouse in property acquired during marriage.[103] Alleviating post-divorce need was not among the acknowledged functions of divorce-related property division.[104]

Until the 1970s, moreover, unscrambling the spouses' respective ownership interests in marital assets was a relatively straightforward task. In the small number of community property states, each spouse was considered an equal co-owner of all assets acquired during marriage as a result of either spouse's efforts.[105] In the much larger number of separate property states, ownership of property acquired during marriage generally followed title principles. In the absence of unusual circumstances surrounding the acquisition of a titled asset, divorce courts awarded the asset to the spouse who held formal title.[106] For non-titled assets, courts generally presumed that the spouse who had provided the income used to acquire the asset was its rightful owner.[107] Since husbands generally provided all or most of

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[103] *See* CLARK, *supra* note 19, at 593 (explaining that the traditional purpose and function of property division was to give to each spouse that property which he or she equitably owned); Gold, *supra* note 2, at 469 (describing the purpose of property division as "unscrambl[ing] the ownership of marital property in an equitable fashion").

[104] Reynolds, *supra* note 102, at 831 (arguing that historically the alleviation of post-divorce need was not a central function of property division); *cf.* W. S. MCCLANAHAN, COMMUNITY PROPERTY LAW IN THE UNITED STATES § 12:3, at 526 (1982) (justifying existence of alimony in community property states on grounds that the division of the marital property could not satisfy economic need).

[105] CLARK, *supra* note 19, at 296; WILLIAM Q. DEFUNIAK & MICHAEL J. VAUGHN, PRINCIPLES OF COMMUNITY PROPERTY 2–3 (2d ed. 1971).

[106] LAWRENCE J. GOLDEN, EQUITABLE DISTRIBUTION OF PROPERTY 4–5 (1983) (under the common law (title) approach, "property rights are determined on the basis of title"); Henry H. Foster, Jr. & Doris J. Freed, *Marital Property Reform in New York: Partnership of Co-Equals?*, 8 FAM. L.Q. 169, 171 (1974) (under traditional common law system, "unless equitable title can be traced, or a constructive trust is imposed, only jointly held property is distributed or made subject to partition if there is a divorce"); Mary A. Glendon, *Is There a Future for Separate Property?*, 8 FAM. L.Q. 315, 316 (1974) ("Upon divorce, the strict application of separate title theory in many states means that if the family assets have been acquired by and held in the name of the husband, he takes them when the household is dismantled."). For examples of judicial application of strict title theory, see, e.g., Norris v. Norris, 307 N.E.2d 181 (Ill. App. Ct. 1974) (applying principle that "ordinary services" performed by wife cannot be taken into consideration in determining property rights, ruling that wife who had worked for twenty-two years both inside and outside the home was not entitled to any property interests in substantial assets acquired during marriage and titled in husband's name); Fischer v. Wirth, 326 N.Y.S.2d 308 (N.Y. App. Div. 1971) (holding that wife was not entitled to any share of investments titled in husband's name even though wife had paid bulk of family expenses and couple had pooled their earnings during most of their forty-year marriage).

[107] *See* Manheim v. Manheim, 302 N.Y.S.2d 473 (N.Y. Sup. Ct. 1969) (holding that husband's purchase of personal property creates inference of ownership which is not defeated by couple's joint use of property during marriage); Smith v. Smith, 120 S.E.2d

the income in households that accumulated substantial assets, application of common law title principles generally resulted in the husband being awarded a lion's share of the property in most divorces.[108]

This conceptual distinction between property division as a means of allocating established ownership interests and alimony as a vehicle for addressing future need was always somewhat blurred in practice. For example, the statutes of most community property states have long empowered their courts to consider future need in dividing community property.[109] Similarly, a number of separate property jurisdictions historically authorized the division of property to effectuate an alimony award.[110] In addition, many separate property states used equitable doctrines such as constructive trust and special equity to ameliorate the harsh effects on divorcing wives of dividing property according to title principles.[111] Despite these equitable intrusions, however, alimony and property division remained conceptually distinct, particularly in separate property states.

Significant practical differences also distinguished alimony awards from property divisions prior to the mid-1970s. In the small number of cases in which alimony was awarded, the award generally took the form of a series of periodic payments from the husband to the wife.[112] Because alimony was linked to a husband's ongoing duty of support, the standard of living estab-

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575 (N.C. 1961) (holding that where husband furnished all monies deposited into joint savings account, husband would be presumed to be the owner); GOLDEN, *supra* note 106, at 5; Foster & Freed, *supra* note 106, at 169, 178–81; Scott Greene, *Comparison of the Property Aspects of the Community Property and Common-Law Marital Property Systems and Their Relative Compatability with the Current View of the Marriage Relationship and the Rights of Women*, 13 CREIGHTON L. REV. 71, 83 & n.65, 85 (1979).

[108] Greene, *supra* note 107, at 85–86; Max Rheinstein, *The Transformation of Marriage and the Law*, 68 NW. U. L. REV. 463, 474 (1973).

[109] Reynolds, *supra* note 102, at 832–33.

[110] *Id.* at 832.

[111] *See* GOLDEN, *supra* note 106, at 7–8; Reynolds, *supra* note 102, at 832 & n.23. As of 1970, approximately half of the common law jurisdictions had statutes authorizing divorce courts, in certain circumstances, to divide a couple's property regardless of which spouse had title. Judith T. Younger, *Marital Regimes: A Story of Compromise and Demoralization, Together with Criticism and Suggestions for Reform*, 67 CORNELL L. REV. 5, 72 (1981). However, "[m]ost courts gave limited scope to these statutes, interpreting them merely to protect the interests of a spouse who provided the capital to acquire a particular asset and using them to 'unscramble' ownership by giving the asset back." *Id.*

[112] CLARK, *supra* note 19, at 653. Although the Supreme Court ruled in Orr v. Orr, 440 U.S. 268 (1979), that alimony must be available to husbands as well as wives, if it is available at all, "[t]he effect of Orr has been more symbolic than practical," and very few husbands are awarded alimony. CLARK, *supra* note 19, at 622.

lished during the marriage was often used as the measure of the wife's entitlement.[113] Consistent with the ongoing nature of the husband's support duty, alimony awards were typically permanent or, more accurately, of indefinite duration.[114] However, since both a wife's needs and a husband's ability to provide for those needs could change over time, alimony awards were generally subject to court modification upon a showing of changed circumstances.[115] In addition, alimony generally terminated upon the death of either the recipient or the obligor, since these events extinguished, respectively, the wife's need for and the husband's ability to provide support.[116] Similarly, if an alimony recipient remarried, her entitlement to alimony automatically ceased, since by virtue of her remarriage she had become the support responsibility of another man.[117]

The division of marital property, by contrast, typically took the form of a one-time transfer or transaction, rather than a series of periodic payments.[118] Thus, property division, unlike alimony, generally did not result in a continuing financial relationship between the parties. Moreover, because property awards represented the allocation of vested ownership interests, they were considered final and could not be modified upon a showing of changed circumstances; nor were such awards affected by the death or remarriage of either spouse.[119] Enforcement of property awards also differed from enforcement of alimony or support orders. Unlike alimony and child support, property awards generally could not be enforced via the con-

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[113] CLARK, *supra* note 19, at 648 ("It was formerly accurate to say that within the limits of the husband's ability to pay, the wife was entitled to an amount of alimony which would support her as nearly as possible at the standard of living which she enjoyed during the marriage.").

[114] *See* WEITZMAN, *supra* note 5, at 164; Jana B. Singer, *Divorce Reform and Gender Justice*, 67 N.C. L. REV. 1103, 1108–09 (1989) (discussing limitations on so-called "permanent" alimony awards).

[115] *See* CLARK, *supra* note 19, at 655–58; Singer, *supra* note 114, at 1108–09.

[116] CLARK, *supra* note 19, at 668–70; *see also* Daggett v. Commissioner, 128 F.2d 568 (9th Cir.), *cert. denied*, 317 U.S. 673 (1942).

[117] CLARK, *supra* note 19, at 663–64; Scheible, *Defining Support*, *supra* note 3, at 16.

[118] *See* HOMER H. CLARK, JR., LAW OF DOMESTIC RELATIONS 450 (1st ed. 1968); Note, *Fresh Start Forgotten*, *supra* note 43, at 475.

[119] CLARK, *supra* note 19, at 592; Scheible, *Defining Support*, *supra* note 3, at 17; Christina M. Gattuso, Note, *The Bankruptcy Reform Act of 1978: Dischargeability of Obligations Incurred Under Property Settlements, Separation Agreements, and Divorce Decrees*, 12 U. BALT. L. REV. 520, 522 (1983).

tempt power of the court.[120] The tax treatment of alimony and property awards also differed significantly.[121]

These conceptual and practical differences between alimony and property awards played significant roles in bankruptcy cases decided prior to the adoption of the 1978 Bankruptcy Code. In particular, bankruptcy courts frequently relied on one or more of these distinctions to determine whether a particular obligation arising out of a debtor's divorce was a dischargeable division of marital property or a nondischargeable support award.[122] Commentators, too, referred to these distinguishing features as bases for differentiating support awards from property divisions in the bankruptcy context.[123]

B. *Recent Developments*

Over the past fifteen years, a series of related family law developments has undermined both the conceptual and the for-

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[120] *See* Scheible, *Defining Support*, *supra* note 3, at 17. In justifying this rule, which applied only to monetary (as opposed to act) decrees, a number of courts reasoned that enforcement of a property award by contempt would violate the constitutional prohibition on imprisonment for debt. *See, e.g.*, Proffit v. Proffit, 462 P.2d 391 (Ariz. 1969); Plumer v. Superior Court, 328 P.2d 193 (Cal. 1958). Other courts argued that the severe sanction of contempt should not be applied to a decree which is not modifiable. *See, e.g.*, McAlear v. McAlear, 469 A.2d 1256 (Md. 1984). For a critique of these justifications, see CLARK, *supra* note 19, at 674. A growing number of courts are now willing to enforce divisions of property by contempt. *Id.*

[121] Under federal income tax law prior to 1984, alimony payments were deductible by the payor and taxable to the payee, while payments in compliance with an award of property were neither taxed to the payee nor deductible by the payor. I.R.C. § 71 (1983); Wright v. Commissioner, 543 F.2d 593 (7th Cir. 1976). The Domestic Relations Tax Reform Act of 1984 eliminated this distinction for all divorce decrees and separation agreements executed after 1984. For a discussion of the Act's provisions, see CLARK, *supra* note 19, at 693–98.

[122] Scheible, *Defining Support*, *supra* note 3, at 24. For example, in *In re* Alcorn, 162 F. Supp. 206 (N.D. Cal. 1958), the court held that a husband's contractual obligation to pay his ex-wife $50 per month as long as she remained "single and unmarried" constituted nondischargeable support. The court distinguished an earlier decision on the ground that the payments in the earlier case were to continue regardless of the wife's subsequent remarriage or the husband's death. *Id.* at 210–11 (distinguishing Edmondson v. Edmondson, 242 S.W.2d 730, 735 (Mo. 1951)). By contrast, in Abrams v. Burg, 327 N.E.2d 745 (Mass. 1975), the Massachusetts Supreme Judicial Court held nondischargeable a husband's divorce-created obligation to make annual payments to his ex-wife for eight years. In characterizing the obligation as a dischargeable property debt, the court emphasized that the obligation was to continue even if the wife died or remarried, that the husband could substitute a lump-sum payment to his wife, and that the decree specified that the payments were not to be considered taxable income to the wife. *Id.* at 747.

[123] *See, e.g.*, John G. Branca, *Dischargeability of Financial Obligations in Divorce: The Support Obligation and the Division of Marital Property*, 9 FAM. L.Q. 405 (1975) (discussing factors used by bankruptcy courts to distinguish property from alimony awards); Loiseaux, *supra* note 38; Note, *Fresh Start Forgotten*, *supra* note 43; Habeeb, *supra* note 38, at 758 (discussing cases).

mal distinctions between spousal support and property division. These developments have hindered the Bankruptcy Code's attempt to distinguish between nondischargeable support awards and dischargeable divisions of marital property.

First, the widespread adoption of equitable distribution principles has effectively merged the functions of property division and spousal support. Indeed, in many jurisdictions, the equitable distribution of marital property has replaced spousal support as the preferred means of providing for the future needs of divorcing spouses. Second, the expansion of the definition of marital property to include such intangible assets as pensions and other forms of deferred compensation, as well as business and professional goodwill, has both changed the structure of many property awards and enhanced the potential of property division to provide for a spouse's post-divorce needs.

Changes in the law and theory regarding alimony have also blurred the distinction between property and support awards. The uncoupling of alimony from the husband's duty of support has reduced the availability of "permanent" alimony and has led to support awards that look and function like extended divisions of marital property. The demise of the husband's support obligation has also spurred a reconceptualization of alimony that emphasizes its compensatory and restitutionary functions, rather than its traditional needs-based justification. This emphasis on alimony as compensation for economic contributions made and losses incurred during marriage has also resulted in the development of hybrid divorce remedies that combine the traditional characteristics of property and support awards. Finally, the increased ability of spouses to determine via contracts the financial consequences of their divorce has led to economic settlements that defy categorization under the traditional support/property dichotomy.

1. The Rise of Equitable Distribution

One of the most important aspects of American divorce reform over the past twenty years has been the widespread adoption of equitable distribution as the basis for allocating property interests at the time of divorce.[124] This nearly universal endorse-

[124] All common law property jurisdictions currently allocate property at divorce by equitable distribution, rather than by title. Doris J. Freed & Timothy B. Walker, *Family*

ment of equitable distribution principles has largely vitiated the conceptual distinction between alimony and property division.[125] This is because the purpose of dividing marital property, under most equitable division schemes, involves more than sorting out the spouses' pre-existing ownership interests in marital assets; rather, it is to allocate those assets between the spouses in a fashion that is just, reasonable, or equitable.[126] Moreover, in determining which distribution of property will satisfy these criteria, courts are typically directed to consider not only historical factors such as the spouses' economic and noneconomic contributions to the marriage, but also such forward-looking criteria as the spouses' post-divorce incomes, employment prospects, and financial needs.[127] Indeed, many equitable distribution statutes focus more on the parties' post-divorce circumstances than on factors relating to the acquisition of assets.[128] These statutes justify the inference that the purpose of equitable distribution "is as much to provide for the financial needs of the spouses after the divorce as to award to each what he or she equitably owns."[129]

Law in the Fifty States: An Overview, 23 FAM. L.Q. 495, 523–24 tbl. 4 (1990). In addition, all but three of the eight community property states authorize equitable, rather than strictly equal, division of property in at least some circumstances. *Id.* Twenty years ago, many common law jurisdictions either failed to authorize the transfer of one spouse's property to the other upon divorce or prohibited or restricted such transfers. *See* Herma Hill Kay, *Beyond No-Fault: New Directions in Divorce Reform*, *in* DIVORCE REFORM AT THE CROSSROADS, *supra* note 5, at 6, 12.

[125] The vast majority of equitable distribution statutes make no attempt to distinguish the purposes of property division from the purposes of an alimony award. CLARK, *supra* note 19, at 592. *But see* NEB. REV. STAT. § 42-365 (1988) (stating that the purpose of property division is to distribute marital assets equitably between the parties, while the purpose of alimony is to provide maintenance or support where appropriate).

[126] CLARK, *supra* note 19, at 593, 600. The original version of the Uniform Marriage and Divorce Act authorized a division of the marital property "in just proportions." The later version of the Act authorizes the court to "equitably apportion" the spouses' property between them. *See* ALASKA STAT. § 25.24.160 (1991) (court to divide property as may be just); ARIZ. REV. STAT. ANN. § 25.318 (1991) (community property to be divided equitably); MICH. COMP. LAWS § 552 (1979) (just and reasonable division); N.J. STAT. ANN. § 2A:34-23 (West 1987) (equitable division); *cf.* Jenks and Jenks, 656 P.2d 286 (Or. 1982) (following rebuttable presumption that both spouses have contributed equally to the acquisition of property during the marriage).

[127] CLARK, *supra* note 19, at 594; *see also* Reynolds, *supra* note 102, at 841 ("Of the forty equitable distribution statutes in separate property states and the District of Columbia, twenty-eight include factors that take into account not only the acquisition of the property but also the needs of the spouses.").

[128] *See* Reynolds, *supra* note 102, at 842 & n.84.

[129] CLARK, *supra* note 19, at 594; *see also* GOLDEN, *supra* note 106, at 268 (1983) (describing the accommodation of future needs as a primary goal of many equitable distribution statutes); KRAUSKOPF, *supra* note 39, at 226 ("A major purpose of equitable distribution in many states is to provide for future support needs."); Reynolds, *supra* note 102, at 843 (observing that state equitable distribution schemes "suggest widespread

The widespread adoption of equitable distribution has done more than blur the conceptual distinctions between property division and spousal support. It has also resulted, to a significant extent, in property division replacing alimony as the preferred means of adjusting the economic relationship of divorcing spouses.[130] The Uniform Marriage and Divorce Act, for example, seeks to promote finality whenever practical by "encourag[ing] the court to provide for the financial needs of the spouses by property disposition rather than by an award of maintenance."[131] Indeed, the Act explicitly precludes a court from awarding maintenance unless it finds that the requesting spouse "lacks sufficient property to provide for his reasonable needs."[132]

Consistent with this emphasis on looking first to property division, rather than to alimony, to meet the spouses' post-divorce needs, many state divorce schemes require that property division precede the determination of eligibility for support and that a spouse's need for support be evaluated in light of any property distributed.[133] If an in-kind division of marital assets is impractical, a court may still use property division to accommodate need by directing a spouse who receives a greater share of tangible assets to repay the other in cash, often by a series of periodic payments.[134] Even in states that have not addressed statutorily the interplay between property and support awards,

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concurrence in the notion that property division should support needy spouses and that property division is preferable to alimony in performing this function"); Scheible, *Fresh Start*, *supra* note 3, at 587–88 ("Increasingly, since the widespread adoption of equitable distribution of property schemes, property division is employed as a substitute for alimony and provides a dependent spouse a means of self-support.").

[130] CLARK, *supra* note 19, at 589; Scheible, *Fresh Start*, *supra* note 3, at 587–88; Mary J. Connell, Note, *Property Division and Alimony Awards: A Survey of Statutory Limitations on Judicial Discretion*, 50 FORDHAM L. REV. 415, 415 (1981) ("The emphasis in modern divorce statutes has shifted from the awarding of alimony to the division of property between the spouses.").

[131] UNIF. MARRIAGE & DIVORCE ACT § 308 cmt., 9A U.L.A. 147, 348 (1987); *see also id.* at *prefatory note*, 9A U.L.A. at 149 (describing the division of property "as the primary means of providing for the future financial needs of the spouses").

[132] *Id.* § 308(a)(1), 9A U.L.A. at 348.

[133] *See, e.g.*, MINN. STAT. § 518.55 (1990); TENN. CODE ANN. § 36-5-101(d)(7) (1984 & Supp. 1990); *In re* Marriage of Jones, 627 P.2d 248 (Colo. 1981); *In re* Marriage of Johnsrud, 572 P.2d 902 (Mont. 1977).

[134] *See* Hellwig v. Hellwig, 426 N.E.2d 1087, 1092 (Ill. App. Ct. 1981) (holding that where in-kind division of marital property would be impractical or inequitable, court may award property to one spouse, subject to repayment to non-acquiring spouse); Ashraf v. Ashraf, 397 N.W.2d 128, 131 (Wis. 1986) (awarding all major assets to husband and requiring husband to pay wife half the value of those assets); Scheible, *Fresh Start*, *supra* note 3, at 587. Although these payments resemble alimony, they are generally understood to represent nonmodifiable ownership interests. *See id.* at 588.

case law often recognizes that economic equity is to be achieved primarily, if possible, through the distribution of property.[135]

One commentator has summed up these developments as follows:

> The message of reform could not have been clearer: property division should perform a support function and is superior to alimony for this task. Property should take over the function of alimony when sufficient property exists. The future needs of an economically dependent spouse should figure foremost in decisions about the division of property, not only in decisions about alimony.[136]

2. Expansion of Definition of Marital Property

The primacy of property division over alimony as a means of allocating marital gains and losses has been reinforced by the expansion of the definition of marital property to include such intangible assets as pensions and business or professional goodwill. While divorce-related property divisions in the past typically involved the allocation of interests in land and other tangible forms of wealth, property obligations today more commonly involve the distribution of pension and other work-related benefits accumulated during marriage.[137] Indeed, many courts assume that the equitable distribution of pension and other retirement benefits performs precisely the same "support" function traditionally associated with long-term alimony. This assumed equivalency is evidenced by cases holding that if a wage-earner's pension has been treated as property for equitable distribution purposes, it cannot also constitute income for purposes of imposing or modifying an alimony award.[138] Several

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[135] *See* O'Brien v. O'Brien, 489 N.E.2d 712, 716 (N.Y. 1985) (stating that purpose of equitable distribution is to eliminate economic dependence); Reynolds, *supra* note 102, at 842–43.

[136] Reynolds, *supra* note 102, at 841.

[137] *See generally* WEITZMAN, *supra* note 5, at 110–42; Grace G. Blumberg, *Marital Property Treatment of Pensions, Disability Pay, Workers' Compensation, and Other Wage Substitutes: An Insurance, or Replacement, Analysis*, 33 UCLA L. REV. 1250 (1986); Mary A. Throne, Note, *Pension Awards in Divorce and Bankruptcy*, 88 COLUM. L. REV. 194, 196–99 (1988).

[138] *See, e.g.*, Kruschel v. Kruschel, 419 N.W.2d 119 (Minn. 1988); D'Oro v. D'Oro, 454 A.2d 915 (N.J. Super. Ct. Ch. Div. 1982), *aff'd*, 474 A.2d 1070 (N.J. Super. Ct. App. Div. 1984); Stemper v. Stemper, 403 N.W.2d 405 (S.D.), *modified on other grounds*, 415 N.W.2d 159 (S.D. 1987); Pelot v. Pelot, 342 N.W.2d 64 (Wis. 1983); *cf.* Staver v. Staver, 13 Fam. L. Rep. (BNA) 1433 (N.J. Super. Ct. Ch. Div. 1987) (holding that pension benefits which accrue during marriage do not constitute income for alimony purposes when they are paid out after the marriage; benefits accruing after the marriage, however, do constitute income).

courts have also held that if a non-employee spouse receives a pension share as part of a division of marital property, a reduced alimony or maintenance award to that spouse may be appropriate.[139]

Thus, fifteen or twenty years ago—before pensions were considered divisible marital assets in most common law property states—a homemaker who divorced after a long-term marriage might be awarded indefinite alimony based, in part, on her husband's expected pension income.[140] Today, that woman is likely to receive, as a full or partial alimony substitute, a percentage share of the pension benefits accumulated as a result of her husband's employment during the marriage.[141]

The increased importance of pensions and other intangible marital assets has also blurred many of the formal distinctions between property and alimony awards. In many divorces, pension benefits earned during marriage constitute by far the most valuable marital asset.[142] Unless a spouse is already retired, however, this asset consists of the right to receive payments in the future.[143] Dividing a pension at the time of divorce, therefore, essentially involves assigning rights to future income, as does a traditional alimony award.[144]

Moreover, because the value of the pension often exceeds the value of all other marital assets, it may be difficult or impossible for divorcing couples to complete the process of property division immediately upon divorce. Rather, to effectuate an equitable division of marital assets, a court must often adopt one of

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[139] *See, e.g.*, Cotter v. Cotter, 473 A.2d 970 (Md. 1984).

[140] *See. e.g.*, *In re* Marriage of Ellis, 538 P.2d 1347 (Colo. Ct. App. 1975) (considering husband's right to retirement pay for purposes of setting alimony); Howard v. Howard, 242 N.W.2d 884 (Neb. 1976) (considering military retirement pay in setting alimony but not regarding military retirement pay as marital property); *In re* Roth, 569 P.2d 693 (Or. 1977) (refusing to classify husband's pension as divisible property but using it as a basis for awarding alimony to wife).

[141] *See, e.g.*, Diffenderfer v. Diffenderfer, 491 So. 2d 265, 268 (Fla. 1986) ("[It is] preferable to deal with pension rights as a marital asset rather than as a source of support obligations."); Keen v. Keen, 407 N.W.2d 643 (Mich. Ct. App. 1987) (disfavoring distribution of pension benefits through alimony); *In re* Marriage of Kernan, 776 P.2d 41 (Or. Ct. App. 1989) (holding that trial court erred in awarding wife spousal support in lieu of a share of husband's retirement benefits).

[142] *See, e.g.*, Brown v. Brown (*In re* Marriage of Brown), 544 P.2d 561, 566, 568 (Cal. 1976); GOLDEN, *supra* note 106, at 167. This assumes that neither a professional degree, nor a spouse's enhanced earning power, counts as a marital asset.

[143] *See generally* GOLDEN, *supra* note 106, at 167–77 (discussing various types of pension interests). Even where a spouse is already retired, pension benefits are still generally received as periodic payments.

[144] In the case of a pension, however, the future income actually represents compensation for services performed in the past.

two forms of deferred distribution: it can either order the spouse who retains the pension to reimburse the other spouse for her share of the asset via a series of periodic payments, or it can award each spouse a specified share of each pension payment "if, as and when" that payment is received.[145] Both of these methods of distribution differ from traditional forms of property division—and resemble traditional alimony awards—in that they involve a series of payments over time, rather than a one-time transfer or transaction. Moreover, both of these methods of distribution involve some degree of continued financial connection between the divorcing spouses, a feature characteristic of traditional support arrangements, but not of traditional property divisions.

Dividing business or professional goodwill often entails a similar process of deferred distribution. Unless the business or professional practice is to be sold at the time of divorce, or unless there are other assets that can be used to offset the value of the goodwill, the equitable division of marital assets is likely to involve a series of payments from one spouse to the other. Like the extended or deferred distribution of a pension, these payments resemble traditional support awards in that they entail a continuing financial relationship between the divorcing parties.[146]

The blurring of the formal and functional distinctions between property division and spousal support has been accompanied by a reduction in the non-bankruptcy consequences of characterizing a divorce obligation as property rather than support. A growing number of jurisdictions, for example, now hold that courts may use their contempt power to enforce divorce-related property obligations, as well as awards of spousal or child support.[147] Similarly, Congress has recently recognized that the

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[145] *See, e.g.*, Koelsch v. Koelsch, 713 P.2d 1234 (Ariz. 1986) (discussing methods of distributing pension benefits); Deering v. Deering, 437 A.2d 883, 890–91 (Md. 1981) (discussing methods of valuation and distribution); GOLDEN, *supra* note 106, at 177–80 (discussing distribution of pension benefits).

[146] They differ from traditional support awards, however, in that they are generally considered final and not subject to modification. If the statutory proposal advocated in this Article were adopted, it might make sense to create an exception to the ban on post-divorce modification of extended property awards where unanticipated changes in the obliger's financial condition render enforcement of such an extended award unconscionable. *Cf.* O'Brien v. O'Brien, 489 N.E.2d 712, 720–21 (N.Y. 1985) (Meyer, J., concurring) (suggesting that property divisions based on one spouse's professional license should be modifiable).

[147] *See, e.g.*, *In re* Marriage of Ramos, 466 N.E.2d 1016 (Ill. App. Ct. 1984) (holding that both property settlement and maintenance provision of dissolution decree were

income tax treatment of payments made pursuant to a divorce settlement or decree should not depend upon whether the payments fit more neatly into the pigeonhole labeled property or the pigeonhole labeled support.[148]

3. Reconceptualization of Alimony

Changes in the law and theory of alimony have also contributed to the conceptual merger of spousal support and property division. Traditionally, alimony represented the judicially mandated continuation of a husband's duty to support his wife.[149] Since the duty of support was the husband's alone, only wives were entitled to alimony. The right to marital support, however, was conditioned on dutiful behavior during marriage; a wife who was the guilty party in a divorce generally forfeited her right to alimony.[150]

The demise of the gender-based marriage contract, in conjunction with no-fault divorce reform, undermined these traditional rationales for awarding alimony. It also left the law of alimony in somewhat of a theoretical vacuum.[151] A number of courts and legislatures initially reacted to this vacuum by reconceptualizing alimony as a short-term transition payment designed to enable formerly dependent spouses to become eco-

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enforceable through contempt proceedings); *In re* Marriage of Lenger, 336 N.W.2d 191 (Iowa 1983) (rejecting argument that use of contempt power to enforce property division embodied in divorce decree violated state constitutional ban on imprisonment for debt); Haley v. Haley, 648 S.W.2d 890 (Mo. Ct. App. 1982); Robinson v. McDanel, 795 P.2d 513 (Okla. 1990) (holding that property rights embodied in a divorce decree are enforceable via contempt); McCrary v. McCrary, 723 P.2d 268 (Okla. 1986) (applying statute that superseded prior contrary authority and provided that contempt power could be used to enforce any order for the payment of money as part of a division of spousal property pursuant to a divorce or separate maintenance action); Hanks v. Hanks, 334 N.W.2d 856 (S.D. 1983) (holding that contempt may be used to enforce property settlement aspects of divorce); *see also* CLARK, *supra* note 19, at 674; Christopher Hall, Annotation, *Divorce: Propriety of Using Contempt Proceeding to Enforce Property Settlement Award or Order*, 72 A.L.R.4TH 298 (1991).

[148] Domestic Relations Tax Reform Act of 1984, Pub. L. No. 98-369, 98 Stat. 494. For a discussion of the provisions of the Act, see CLARK, *supra* note 19, at 693–98; J. Thomas O'Brien, Jr., Note, *The Effect of the Tax Reform Act of 1984 on Alimony and Transfers of Property Incident to Divorce*, 19 U. RICH. L. REV. 129 (1984).

[149] CLARK, *supra* note 19, at 619–20; Ira M. Ellman, *The Theory of Alimony*, 77 CAL. L. REV. 1, 5–6 (1989).

[150] *See* Singer, *supra* note 114, at 1110.

[151] *See* Ellman, *supra* note 149, at 6.

nomically self-sufficient as soon as possible.[152] To this end, trial courts in a number of jurisdictions largely replaced so-called permanent alimony with short-term "rehabilitative" awards.[153]

Recent appellate and legislative developments have attempted to curb the inappropriate use of short-term alimony, particularly in marriages of long duration.[154] Many jurisdictions, however, continue to prefer short-term rehabilitative or transitional awards over permanent alimony wherever feasible.[155] These rehabilitative awards differ from traditional alimony—and resemble the division of marital property—in that they generally consist of a definite and limited number of payments, paid out over a specific time period. Moreover, unlike traditional alimony obligations, these limited-term awards are often considered nonmodifiable or modifiable only in extreme circumstances.[156] In addition, one of the express purposes of rehabilitative alimony

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[152] *See, e.g.*, Reback v. Reback, 296 So. 2d 541 (Fla. Dist. Ct. App. 1974); Sansone v. Sansone, 615 S.W.2d 670 (Mo. Ct. App. 1981); Turner v. Turner, 385 A.2d 1280 (N.J. 1978); Henry H. Foster & Doris J. Freed, *Spousal Rights in Retirement and Pension Benefits*, 16 J. FAM. L. 187, 191 (1977–1978) (with the advent of no-fault divorce, alimony "has come to be regarded as an interim stipend which is available for a relatively short time while a former spouse in need prepares for the labor market"). Several states also adopted statutes limiting the duration of alimony awards. *E.g.*, DEL. CODE ANN. tit. 13 § 1512(a)(3) (1981) (limiting alimony to two years if the marriage lasted less than 20 years); N.H. REV. STAT. ANN. § 458:19 (1983) (limiting alimony to three years if there are no children). For a discussion and critique of these developments, see Linda B. Marshall, *Rehabilitative Alimony: An Old Wolf in New Clothes*, 13 REV. LAW & SOC. CHANGE 667 (1985).

[153] *See* Joan M. Krauskopf, *Rehabilitative Alimony: Uses and Abuses of Limited Duration Alimony*, *in* AMERICAN BAR ASSOCIATION, SECTION OF FAMILY LAW, ALIMONY: NEW STRATEGIES FOR PURSUIT AND DEFENSE 65, 70–71 (1988) (discussing and criticizing cases); Marshall, *supra* note 152.

[154] *See, e.g.*, MINN. STAT. § 518.552, subdiv. 3, *amended by* 1985 Minn. Laws 266 ("[N]othing in this section shall be construed to favor a temporary award of maintenance over a permanent award, where the factors . . . justify a permanent award."); Morrison v. Morrison (*In re* Marriage of Morrison), 573 P.2d 41 (Cal. 1978) (reversing limited duration award to 54-year-old wife with minimal work experience after a 28 year marriage); Walter v. Walter, 464 So. 2d 538 (Fla. 1985) (reversing lower court's disapproval of permanent alimony and expressly disapproving court's statement that permanent alimony should be awarded only as a last resort and only upon a showing of lack of capacity for self-support); Lewis v. Lewis, 739 P.2d 974 (N.M. 1987) (holding that a 62-year-old homemaker whose husband was well able to afford permanent alimony had no obligation to "rehabilitate" herself by seeking full-time employment outside the home); Toler v. Toler, 356 S.E.2d 429 (S.C. Ct. App. 1987) (concluding that record failed to demonstrate requisite likelihood of self-sufficiency to justify rehabilitative alimony where the claimant was a 42-year-old homemaker with limited education and job experience); *see also* Kay, *supra* note 124, at 16. *See generally* Krauskopf, *supra* note 153, at 70–74 (discussing recent appellate trend away from over-reliance on short-term alimony awards).

[155] *See* Scheible, *Fresh Start*, *supra* note 3, at 589.

[156] *Id.* at 589 & n.67 (citing cases).

is to minimize the possibility of an ongoing financial relationship between the parties.

Growing concern about the disparate economic effects of divorce on women (and children) has highlighted the inadequacy of treating alimony as simply a short-term transition payment, designed to facilitate economic self-sufficiency. These concerns have led both scholars and policy-makers to rethink the nature and functions of alimony. A consensus is emerging among family law scholars that alimony and property division share a single, fundamental purpose: to apportion fairly the economic gains and losses that result from participation in a marriage.[157] In particular, a number of family law scholars have recently argued that alimony (or a similar form of post-divorce income sharing) is both appropriate and necessary to prevent the unjust enrichment of an economically dominant spouse who has benefitted financially as a result of marriage, and/or to compensate an economically dependent spouse for the loss of earning capacity associated with her assumption during marriage of primary childcare and household duties.[158]

It is significant, for purposes of bankruptcy law, that both of these emerging justifications for alimony focus primarily on the spouses' gains and losses during marriage, rather than on their post-divorce needs. Alimony, under these theories, is still forward-looking in that it deals with the allocation of the spouses' future income. But the justifications for that allocation are increasingly grounded in the past: they focus centrally on the parties' contributions and sacrifices during marriage, and on the continuing effects of those marital activities on the parties' respective post-divorce earnings.[159]

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[157] Krauskopf, *supra* note 1, at 256.

[158] *See, e.g.*, Katharine K. Baker, *Contracting for Security: Paying Married Women What They've Earned*, 55 U. CHI. L. REV. 1193 (1988); Ralph J. Brown & Linda L. Viken, *Recognition of Homemaker Career Opportunity Cost in Marital Dissolution Cases*, 35 S.D. L. REV. 40 (1990); June Carbone, *Economics, Feminism, and the Reinvention of Alimony: A Reply to Ira Ellman*, 43 VAND. L. REV. 1463 (1990); Lloyd Cohen, *Marriage, Divorce, and Quasi Rents; or "I Gave Him the Best Years of My Life"*, 16 J. LEGAL STUDIES 267 (1987); Ellman, *supra* note 149, at 1; Sally F. Goldfarb, *Marital Partnership and the Case for Permanent Alimony*, *in* AMERICAN BAR ASSOCIATION, *supra* note 150, at 45 (1988); Mary E. O'Connell, *Alimony After No-Fault: A Practice in Search of a Theory*, 23 NEW ENG. L. REV. 437 (1988); June Rutherford, *Duty in Divorce: Shared Income as a Path to Equality*, 58 FORDHAM. L. REV. 539 (1990).

[159] *Cf.* Carl Schneider, *Rethinking Alimony: Marital Decisions and Moral Discourse*, 1991 B.Y.U. L. REV. 197, 257 (endorsing what author describes as the "traditional justification for alimony . . . that people who marry take on special responsibilities for each other because of the commitment that defines marriage and because of the commitments that grow out of a shared life").

Recent legislative and judicial developments also emphasize these compensatory justifications for alimony. A number of state statutes now explicitly require courts, in awarding alimony, to consider any contributions that one spouse has made to the other's professional education, training, or career.[160] Similarly, several states have recently amended their list of required alimony considerations to include "the extent to which the spouse seeking maintenance has reduced his or her income or career opportunities for the benefit of the other spouse."[161] Recent case law in a number of jurisdictions also stresses the importance of alimony as a means of compensating financially dependent spouses for contributions made or economic losses incurred over the course of a marriage.[162]

4. The Creation of Hybrid Divorce Remedies

This increased emphasis on the compensatory and restitutionary functions of alimony has also led to the creation of hybrid divorce awards that defy categorization under the traditional support versus property framework. Perhaps the most common occasion for such hybrid awards is a divorce that occurs shortly after one spouse has supported the other through graduate or professional school.[163] Because the divorce occurs soon after the supported spouse obtains his degree, the other spouse is unable to share in the increased standard of living that both spouses had expected the degree to provide. Moreover, because the couple has invested most of its resources in achieving the

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[160] *See, e.g.*, CAL. CIV. CODE § 4801(a) (West Supp. 1992); FLA. STAT. § 61.08 (1985); IND. CODE § 31-1-11.5-11(e) (1979); IOWA CODE § 598.21 (1981); N.Y. DOM. REL. LAW § 236(B) (McKinney 1990); OHIO REV. CODE ANN. § 3105.18 (Baldwin 1989); OR. REV. STAT. § 107.105(d) (1991); TENN. CODE. ANN. § 36-5-101(d) (1991); WIS. STAT. § 767 (1981).

[161] ARIZ. REV. STAT. § 25-319(B)(7) (1987); *see also* N.Y. DOM. REL. LAW § 236(B)(6)(a)(5); OR. REV. STAT. § 107.105(d)(F).

[162] *See, e.g., In re* Marriage of K.B., 648 S.W.2d 201, 295 (Mo. Ct. App. 1983); Heim v. Heim, 763 P.2d 678 (Nev. 1988); Weir v. Weir, 374 N.W.2d 858 (N.D. 1985); Fernau v. Fernau, 694 P.2d 1092 (Wash. Ct. App. 1984); *In re* Marriage of LaRocque, 406 N.W.2d 736 (Wis. 1987).

[163] In the vast majority of reported cases, the husband earns the professional degree, while the wife provides financial and family support. For a general discussion of this problem, and the legal responses to it, see, e.g., IRA M. ELLMAN ET AL., FAMILY LAW: CASES, TEXT, PROBLEMS 321–51 (2d ed. 1991); Deborah A. Batts, *Remedy Refocus: In Search of Equity in "Enhanced Spouse/Other Spouse" Divorce*, 63 N.Y.U. L. REV. 751 (1988); Joan M. Krauskopf, *Recompense for Financing Spouse's Education: Legal Protection for the Marital Investor in Human Capital*, 28 KAN. L. REV. 397 (1980).

degree, few—if any—traditional assets are available for equitable distribution.

The majority of states that have addressed this situation have not considered a graduate or professional degree to be marital property subject to division.[164] These same states have held, however, that a spouse who contributes in this manner to her partner's graduate or professional training has a strong claim for financial compensation, even if she would not otherwise qualify for spousal support under the prevailing state law standards.[165] To provide this compensation, a number of jurisdictions have endorsed the concept of "reimbursement" or "restitutional" alimony.[166]

Awards of "reimbursement" or "restitutional" alimony generally take the form of a sum certain payable in installments.[167] Unlike traditional periodic alimony, these hybrid divorce awards generally are not modifiable and do not terminate upon a recipient's remarriage.[168] Thus, although such awards carry the label "alimony," they are both formally and functionally akin to the equitable division of marital property.[169]

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[164] *See* Kay, *supra* note 124, at 14. New York is the notable exception to the majority view. *See* O'Brien v. O'Brien, 498 N.E.2d 712 (N.Y. 1985) (holding that medical license was marital property subject to division under state's equitable distribution statute). The Michigan Court of Appeals recently adopted a modified marital property analysis. Postema v. Postema, 471 N.W.2d 912 (Mich. Ct. App. 1991).

[165] *See* Note, *Spousal Interest in Professional Degrees: Solving the Compensation Dilemma*, 31 B.C. L. REV. 749, 750 (1990).

[166] *See, e.g.*, CALIF. CIVIL CODE § 4800.3 (Supp. 1992) (requiring "reimbursement" upon divorce to the marital community "for community contributions to education or training of a party that substantially enhances the earning capacity of the party"); *In re* Marriage of Francis, 442 N.W.2d 59 (Iowa 1989); Mahoney v. Mahoney, 453 A.2d 527 (N.J. 1982); Bold v. Bold, 574 A.2d 552 (Pa. 1990); Petersen v. Petersen, 737 P.2d 237, 242 n.5 (Utah Ct. App. 1987); Hoak v. Hoak, 370 S.E.2d 473 (W. Va. 1988). A number of prominent family law commentators have endorsed the concept of reimbursement alimony. Professor Joan Krauskopf, for example, has proposed the use of a non-modifiable monetary award, which she sees as akin to maintenance in gross, as "the most justifiable way in which to recompense a spouse who has contributed to the other spouse's increased earning capacity." Krauskopf, *supra* note 163, at 401. Similarly, Professor Herma Hill Kay has called for the adoption of a hybrid divorce award "that can combine the flexibility of a support order with the permanence of a property award." Kay, *supra* note 124, at 23. *But cf.* Ellman, *supra* note 149, at 24–28 (criticizing restitution as a conceptual basis for alimony).

[167] *See Mahoney*, 453 A.2d at 535–36; Scheible, Fresh Start, *supra* note 3, at 590.

[168] *See Francis*, 442 N.W.2d at 60 ("Reimbursement alimony . . . which is predicated upon economic sacrifices made by one spouse during the marriage that directly enhance the future earning capacity of the other, should not be subject to modification or termination until full compensation is achieved."); Smith v. Smith, 540 A.2d 1348, 1349 (N.J. Super. Ct. Ch. Div. 1988) (describing the purpose of reimbursement alimony as compensation rather than support); Zullo v. Zullo, 576 A.2d 1070, 1075 (Pa. Super. Ct. 1990) (holding that reimbursement alimony is not subject to termination on remarriage); Scheible, *Fresh Start*, *supra* note 3, at 590.

[169] *See Francis*, 442 N.W.2d at 64 ("Similar to a property award, but based on future

Other courts have eschewed the alimony label and have utilized principles of equity and contract law to fashion hybrid divorce remedies that combine the traditional attributes of support and property awards. For example, in *Pyeatte v. Pyeatte*,[170] the Arizona Court of Appeals held that a divorcing wife was entitled to quasi-contractual relief where she had made substantial financial contributions to her husband's education, pursuant to an oral understanding that was too indefinite to qualify as a contract.[171] Similarly, in *DeLa Rosa v. DeLa Rosa*,[172] the Minnesota Supreme Court invoked restitution theory to award a divorcing wife sums she had expended for her student husband's education and living costs, even though she did not qualify for spousal maintenance under the governing statute.[173]

More recently, the Michigan Court of Appeals combined support and property principles to rule that where one spouse's advanced degree is the product of a "concerted family effort involving mutual sacrifice, effort, and contribution," it creates a "marital asset" as to which the non-student spouse has an "equitable claim" for compensation.[174] The court explicitly rejected prior decisions that had characterized an advanced degree earned during marriage as a factor to be considered in awarding alimony, rather than a marital asset subject to distribution.[175] However, the court also rejected a pure property analysis that would have given the non-student spouse an interest in the degree itself, and therefore entitled her to a percentage share of the present value of the degree.[176] Instead, the court held that the nonstudent spouse's compensatory claim should be valued by first examining "her sacrifices, efforts and contributions toward the attainment of the degree" and then determining, in light of those sacrifices, "what remedy or means of compensation would most equitably compensate the nonstudent spouse

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earning capacity rather than a division of tangible assets, [reimbursement alimony] should be fixed at the time of the decree."); *Smith*, 540 A.2d at 1349.

[170] 661 P.2d 196 (Ariz. Ct. App. 1983).

[171] *Id.* at 207.

[172] 309 N.W.2d 755 (Minn. 1981).

[173] *Id.* at 758.

[174] Postema v. Postema, 471 N.W.2d 912, 917 (Mich. Ct. App. 1991).

[175] *Id.* at 913–17.

[176] *Id.* at 920–21. In support of this conclusion, the court quoted with approval the reasoning of an earlier panel decision that had rejected the view that an advanced degree constituted divisible marital property and had instead adopted an alimony approach. *Id.* (quoting Krause v. Krause, 441 N.W.2d 66, 72–73 (Mich. Ct. App. 1989)).

under the facts of the case."[177] The court recognized that such compensation could be effectuated in different ways. It gave two examples: an award which requires the degree-earning spouse to finance an equivalent education or training opportunity for the nonstudent spouse, and an award reimbursing the nonstudent spouse for the amount of financial assistance she contributed toward the degree, taking into account her nonpecuniary sacrifices and efforts.[178] The court also noted that either of these awards could be made payable in monthly installments, with interest, over a fixed period of time.[179]

The creation and justification of the hybrid divorce awards discussed above represent a frontal assault on the traditional dichotomy between property division and spousal support. Divorce remedies such as equitable compensation, and "reimbursement" or "restitutional" alimony not only defy categorization under a support versus property framework, they also show the increasing convergence of both the theoretical justifications for, and the practical functions of, property division and spousal support.

5. The Increased Role of Private Contracting

A final family law development that has undermined the support/property distinction is the increased ability of spouses to determine by private contract the financial consequences of divorce. Although couples and their attorneys have long used out-of-court settlements to resolve economic issues related to divorce, states traditionally imposed significant limitations on the scope and content of these agreements.[180] Prior to the late 1970s, for example, most states largely precluded couples from contracting before or during an intact marriage about the financial consequences of divorce.[181]

States also imposed significant constraints on contracts negotiated at the time of divorce. Because the husband's support

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[177] *Id.* at 923.
[178] *Id.* at 926.
[179] *Id.* at 927.
[180] *See generally* Sally Burnett Sharp, *Divorce and the Third Party: Spousal Support, Private Agreements, and the State*, 59 N.C. L. REV. 819, 827–32 (1981).
[181] CLARK, *supra* note 19, at 6–7, 10. Such contracts between spouses or prospective spouses were thought to violate public policy by unduly encouraging divorce and by altering the essential incidents of marriage, particularly the husband's duty of support. *Id.*; *see also* Sally Burnett Sharp, *Fairness Standards and Separation Agreements: A Word of Caution on Contractual Freedom*, 132 U. PA. L. REV. 1399–1400 (1984).

obligation was imposed by law, courts traditionally held that it could not be contracted completely away.[182] In theory at least, judges were expected to scrutinize separation and divorce agreements to ensure that their support provisions were "'fair, just and reasonable in view of all the circumstances.'"[183] Although such judicial scrutiny was often perfunctory, it was not uncommon for courts to assert the right to reject a divorce agreement on the sole ground that its alimony and/or property provisions differed from the provisions that the court would have imposed.[184] Most states also subjected divorce-related financial agreements to rigorous procedural scrutiny, relying on a presumed confidential relationship between the spouses that persisted well into the divorce process.[185]

Divorcing couples today have considerably more freedom than in the past to determine privately the financial consequences of divorce.[186] Indeed, courts and commentators today generally favor private resolution of financial issues as a means of encouraging amicable dissolution, fostering certainty and finality, and promoting judicial economy.[187] Although some courts still purport to scrutinize divorce agreements for both procedural and substantive fairness, a growing number of jurisdictions defer to privately negotiated divorce agreements in much the same way as they do to other types of private contracts.[188]

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[182] Sharp, *supra* note 180, at 830–31.

[183] *Id.* at 832 (quoting 1 ALEXANDER LINDEY, LINDEY ON SEPARATION AGREEMENTS AND ANTENUPTIAL CONTRACTS § 15, at 15-91 (rev. ed. 1978)). It is questionable, however, whether such a fairness requirement existed in practice. *See id.* at 832–33.

[184] *See* CLARK, *supra* note 19, at 773, 773 n.15 (citing cases from states across the country in which courts assert discretionary power to modify or invalidate agreements); Note, *supra* note 38, at 732.

[185] *See* Sharp, *supra* note 181, at 1415–23; Sharp, *supra* note 180, at 834–38.

[186] *See* CLARK, *supra* note 19, at 774; Jana B. Singer, *The Privatization of Family Law*, 1992 WIS. L. REV. (forthcoming 1992).

[187] *See, e.g.*, UNIF. MARRIAGE & DIVORCE ACT prefatory note, 9A U.L.A. 147, 149 (1987) (explaining that the Act attempts to "reduce the adversary trappings of marital litigation" by encouraging parties "to make amicable settlements of their financial affairs"); CLARK, *supra* note 19, at 756–57, 774–75 (referring to the "obvious need for and advantages of separation agreements as devices for compromising marital disputes and for avoiding the expense, delay, and stress of litigation"); Scheible, *Fresh Start*, *supra* note 3, at 591 ("Permitting divorcing couples to determine contractually their post-marital financial relationship reflects a state family law policy of encouraging amicable dissolution and fostering certainty."); Sally Burnett Sharp, *Semantics as Jurisprudence: The Elevation of Form over Substance in the Treatment of Separation Agreements in North Carolina*, 69 N.C. L. REV. 319, 319–29 (1991) (maintaining that private agreements reduce psychological and economic costs of divorce, foster post-divorce cooperation, decrease the negative impact of divorce on children, and promote judicial economy).

[188] *See, e.g.*, Brighton v. Brighton, 517 So. 2d 53 (Fla. Dist. Ct. App. 1987) (holding that where there is no fraud or overreaching and the parties have full knowledge, an

This increased reliance on privately negotiated divorce arrangements undermines the doctrinal division between support awards and property divisions in a number of ways. First, many divorce agreements do not indicate whether a particular financial obligation represents a support award, a division of property, or a combination of the two.[189] This lack of precise identification makes it more difficult later to characterize the award for purposes of a subsequent discharge in bankruptcy.

Moreover, privately negotiated divorce agreements often contain little, if any, information about the parties' respective financial needs and circumstances. Nor do such agreements generally recite in any detail the reasons for the financial arrangements that the parties have entered into. To the extent that a bankruptcy court's characterization of a divorce obligation now depends upon an assessment of the relative economic positions of the spouses at the time of divorce, privately negotiated divorce arrangements are likely to provide little relevant historical information.

Divorcing spouses also can agree privately to financial obligations that differ from or go beyond the obligations that a court could impose on its own. For example, the parties may agree to extend the scope or the duration of a "support" award beyond what state law would authorize a court to order.[190] Similarly, a

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unfair or unconscionable agreement will not be set aside), *appeal denied*, 528 So. 2d 1181 (Fla. 1988); *In re* Marriage of Van Zuidam, 516 N.E.2d 331 (Ill. App. Ct. 1987) (stating that proper standard to review propriety of settlement agreement is unconscionability, rather than mere unfairness), *appeal denied*, 520 N.E.2d 393 (Ill. 1988); Shaffer v. Shaffer (*In re* Shaffer), 733 P.2d 1013 (Wash. Ct. App.) (deciding that only question for trial court reviewing separation agreement is whether the agreement was unfair when it was executed, an inquiry which turns on whether the agreement was entered into fairly, not whether the agreement was economically fair), *appeal denied*, 108 Wash. 2d 1024 (Wash. 1987); UNIF. MARRIAGE & DIVORCE ACT § 306(b)-(c), 9A U.L.A. 147, 216 (1987) (requiring court to approve terms of separation agreement except those providing for child support or custody, unless the court finds the agreement to be unconscionable).

A number of jurisdictions purport to subject separation agreements to a substantive fairness review not generally applicable to commercial contracts. *See* 1 ALEXANDER LINDEY & LOUIS I. PARLEY, LINDEY ON SEPARATION AGREEMENTS AND ANTENUPTIAL CONTRACTS §§ 6.01-.02, at 6-12 to -18 (rev. ed. 1992). However, "these enunciated fairness standards are often interpreted very narrowly . . . . Thus what appears to be a substantive review standard is often a procedural standard only." Sharp, *supra* note 181, at 1409. Moreover, the judicial review process "is almost wholly perfunctory in most states" and "it is extremely rare for a court to undertake sua sponte any review that would result in modification of any proposed agreement." *Id.* at 1409-10.

[189] Scheible, *Fresh Start*, *supra* note 3, at 590-91; *see also* Sharp, *supra* note 180, at 826-27.

[190] *See, e.g.*, Cutshaw v. Cutshaw, 261 S.E.2d 52 (Va. 1979) (holding that parents may contract to extend their legal obligation to support and maintain a child after majority); Beard v. Worrell, 212 S.E.2d 598, 607 (W. Va. 1974) (upholding contractual alimony

couple may agree to make final and non-modifiable an obligation that state law ordinarily would treat as subject to modification or as terminable upon the recipient's remarriage.[191] Conversely, divorcing spouses can agree to an arrangement that resembles (or is labeled) a division of property yet permits modification if certain contingencies occur. Thus, the parties' ability to transcend the constraints and categories of state domestic relations law diminishes the relevance of the support/property dichotomy and complicates the later characterization of the obligation as either a nondischargeable support award or a dischargeable property division.

C. *Summary*

As a result of these interconnected family law developments, neither form nor function continues to provide a reliable basis for differentiating support awards from property divisions. A non-modifiable monetary award, paid out in a single lump sum or over a limited time period, can represent either an equitable division of marital property or an award of "rehabilitative" or "reimbursement" alimony. Similarly, a divorce judgment (or agreement) that entitles one spouse to a specified share or amount of the other spouse's future income can represent either the deferred distribution of a pension or an award of indefinite alimony. Thus, neither the finality of a divorce award nor its duration or payment structure provides a reliable guide for distinguishing dischargeable property obligations from nondischargeable support awards.

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although court could not have ordered alimony in light of wife's fault); CLARK, *supra* note 19, at 766–67; Scheible, *Defining Support*, *supra* note 3, at 15.

[191] *See, e.g.*, CAL. CIV. CODE § 4811(b) (West 1983 & Supp. 1992) (permitting modification of alimony except where the parties' agreement expressly provides otherwise); *In re* Marriage of Lee, 781 P.2d 102 (Colo. Ct. App. 1989) (deciding that only where parties agree to preclude modification of maintenance awards is maintenance incapable of modification under Colorado law); UNIF. MARRIAGE & DIVORCE ACT §§ 306(f), 316(a)–(b), 9A U.L.A. 147, 217, 489–90 (1987) (separation agreement may preclude or limit modification of maintenance); 1 LINDEY & PARLEY, *supra* note 188, § 15A.04, at 15A-105, -111 (payor spouse may lawfully agree to continue support payments after his death and/or after the recipient spouse remarries); Scheible, *Fresh Start*, *supra* note 3, at 591 & n.76 (citing cases that hold contractual terms to be unmodifiable, as well as contrary cases that permit modification, particularly by mandatory statute, despite conflicting contractual language). Divorce agreements may also limit future modifiability by specifying the circumstances that will govern modification. *See* 1 LINDEY & PARLEY, *supra* note 188, § 15A.04, at 15A-103 to -123.

Nor is it possible, in light of these family law developments, to distinguish support from property division on a functional or conceptual basis. With the advent of equitable distribution, property awards now constitute an acknowledged—and in many cases preferred—means of providing for the future needs of economically dependent spouses. Conversely, support awards, as well as property divisions, can function legitimately as compensation for contributions made or economic opportunities foregone during marriage. Moreover, a single divorce obligation may serve several of these functions simultaneously. In sum, as a noted family law scholar has observed in a different context, the Bankruptcy Code's attempt to distinguish between nondischargeable support awards and dischargeable property divisions "is based on the fiction that there is some perceptible difference between awards of alimony and of property. There is no such difference."[192]

III. Practical Effects of the Support/Property Distinction

The preceding discussion establishes that the Bankruptcy Code's current treatment of divorce obligations rests on an increasingly untenable legal fiction. The Code's support/property distinction also generates a number of practical difficulties for divorcing spouses. In particular, the distinction creates unnecessary hardship for divorce obligees and inappropriately skews the process of divorce negotiations.

A. *Procedural Hurdles for the Divorce Obligee*

When a debtor with divorce obligations declares bankruptcy, the debtor's ex-spouse must relitigate in the bankruptcy context many of the same financial issues that she previously litigated (or negotiated) in connection with the divorce. She must do so, moreover, in a forum that gives first priority to the debtor's interests.[193] While the spouses stand on an equal footing in state divorce proceedings, federal bankruptcy court "is a debtor's

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[192] Clark, *supra* note 19, at 658. Even federal income tax law has abandoned its attempt to distinguish between alimony and property division, in part because of the tremendous amount of litigation the purported distinction produced. *See id.* at 691–94.

[193] *See* Throne, *supra* note 137 at 204–06.

court where the system promotes discharge of the debtor's obligations."[194] Exceptions to discharge are strictly construed in favor of the debtor, and the objecting spouse bears the burden of proving that a particular divorce obligation is nondischargeable.[195] The fact that the divorce decree or settlement agreement characterizes the obligation as alimony, maintenance, or support does not shift this burden of proof.[196]

Moreover, after obtaining a right at the state level where both spouses have the same status, the divorce obligee appears in bankruptcy court as an ordinary creditor.[197] Unlike the ordinary creditor, however, she has not entered into an arm's-length relationship with the debtor. Instead, her claims grow out of an intimate, personal relationship, often one that has endured for a substantial period of time. Moreover, unlike most commercial creditors, the divorce obligee could not have diversified and insured against her risks.[198] It is also highly unlikely that the nondebtor spouse would have analyzed the risk of divorce and subsequent bankruptcy when she began her relationship with the debtor or contributed to his economic well-being.

The unique procedures applicable to bankruptcy cases create additional hurdles for the divorce obligee. The moment a debtor files for bankruptcy, section 362 of the Bankruptcy Code imposes an automatic stay on virtually all collection efforts against the debtor.[199] The Code excepts from this automatic stay actions for "the collection of alimony, maintenance, or support from

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[194] *Id.* at 205.

[195] BANKR. R. 4003(c) (party objecting to discharge bears burden of proof); Freeburger & Bowles, *supra* note 68, at 596–97; Throne, *supra* note 137, at 204–06.

[196] Freeburger & Bowles, *supra* note 68, at 597; *see also* Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1111 (6th Cir. 1983). Moreover, a number of courts have applied a test based on intent which requires the nondebtor spouse to prove that both she and the debtor intended to create a support obligation—an impossible task in many cases. *See, e.g.*, Tilley v. Jessee, 789 F.2d 1074, 1078 (4th Cir. 1986) (holding that even though husband conceded that wife used disputed payments for her support, wife failed to carry her burden of proving mutual intent to create support award); Helm v. Helm (*In re* Helm), 48 B.R. 215, 221 (Bankr. W.D. Ky. 1985) (concluding that while wife may have regarded payments as alimony, she failed to prove that her husband shared that intent).

[197] *See* Throne, *supra* note 137, at 205.

[198] *Id.* at 206.

[199] 11 U.S.C. § 362(a); *see also* Janet L. Chubb et al., *Divorce and Bankruptcy: A Dangerous Liaison*, 4 AM. J. FAM. L. 339, 347 (1990). The purposes of the automatic stay are to provide a breathing spell for the financially troubled debtor and to preserve the bankrupt debtor's estate. *See id.* at 347; White, *supra* note 100, at 10. One authority has summarized the effects of the automatic stay as follows: "In short, upon the filing of the petition the creditor may continue to eat, sleep and breathe; perhaps he can smile at the debtor, but he may do little else." JAMES J. WHITE, BANKRUPTCY AND CREDITORS' RIGHTS 97 (1985).

property that is not the property of the estate."[200] However, because federal law, rather than state law, determines whether a particular divorce obligation constitutes "alimony, maintenance, or support" for purposes of this exception, a divorce obligee acts at her peril in attempting to enforce any divorce obligation after her ex-spouse files for bankruptcy.[201] If a bankruptcy court later rules that the disputed obligation is not "actually in the nature of . . . support," her collection efforts may violate the automatic stay and result in contempt proceedings or other sanctions.[202] Even unintentional violations of the automatic stay provisions may result in damage awards, including costs and attorneys' fees.[203]

In light of these potential pitfalls, bankruptcy commentators generally caution that if there is any uncertainty about the dischargeability of a divorce obligation, the nondebtor spouse should obtain a ruling from the bankruptcy court regarding the applicability of the automatic stay before attempting to enforce

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[200] 11 U.S.C. § 362(b)(2). This exception has been interpreted to apply only to actions and proceedings to enforce support obligations evidenced by an order or judgment entered before the bankruptcy case is filed. White, *supra* note 100, at 13–14. The Code stays all other family law actions, including dissolution proceedings, actions for support, alimony, or maintenance awards, and actions for a division of property. *Id.* at 14. Moreover, the property from which support, alimony, and maintenance may be collected is limited to property that is not the property of the estate. 11 U.S.C. § 362(b)(2); White, *supra* note 100, at 13–14. In Chapter 7 bankruptcies, wages earned by a debtor for services performed after the commencement of the case are not property of the estate. 11 U.S.C. § 541(a)(6). Thus, a Chapter 7 debtor's post-petition wages and any property acquired from those wages may be garnished or attached to satisfy court-ordered alimony, maintenance, or support obligations without violating the automatic stay. *See* White, *supra* note 100, at 14–15.

[201] Chubb et al., *supra* note 199, at 351; White, *supra* note 100, at 17–18.

[202] Pody v. Pody (*In re* Pody), 42 B.R. 570, 573–74 (Bankr. N.D. Ala. 1984) (holding that ex-spouse violated automatic stay by not releasing garnishment on debtor's wages in an effort to collect a debt determined to be a nondischargeable property settlement obligation); Stamper v. Stamper (*In re* Stamper), 17 B.R. 216, 221 (Bankr. S.D. Ohio 1983) (holding ex-spouse in contempt of bankruptcy court for violating automatic stay by initiating state court contempt action against debtor before obtaining a determination of the dischargeability of family obligation); Brock v. Barlow (*In re* Brock), 58 B.R. 797 (Bankr. S.D. Ohio 1981) (ordering ex-wife who obtained contempt order against debtor husband to pay damages of $8,892.50 for willful violation of automatic stay); *see also* Chubb et al., *supra* note 199, at 351–52; White, *supra* note 100, at 21–23 ("Orders or judgments obtained in violation of the stay are frequently held to be nullities and attorneys as well as clients are regularly found in contempt of the bankruptcy court, fined, and ordered to pay damages for willful violations of the stay."). *See generally* Lewis J. Heisman, Annotation, *Violation of Automatic Stay Provisions of 1978 Bankruptcy Code (11 U.S.C. § 362) as Contempt of Court*, 57 A.L.R. FED. 927 (1982).

[203] *In re* McDonald, 98 B.R. 1015 (Bankr. S.D. Fla. 1989); *In re* Ducich, 385 F. Supp. 1287 (C.D. Cal. 1974) (finding a violation but no contempt); *see also* Chubb et al., *supra* note 199, at 352. Such penalties can be assessed against an attorney even though the attorney may be unfamiliar with the Bankruptcy Code and its automatic stay provisions. *See id.*

the obligation.[204] Under the current Bankruptcy Code, such uncertainty is likely to exist in most cases.[205]

Obtaining a ruling from the bankruptcy court and generally participating in bankruptcy proceedings are likely to require the services of an attorney. This, in turn, generally requires access to money—something that many divorced obligees lack, particularly if their ex-husbands have ceased complying with court-ordered divorce obligations. Even if money is not a problem, the non-debtor spouse who seeks to protect her interests must still locate an attorney with expertise in bankruptcy law since the attorney who handled her divorce most likely will not be qualified to represent her in the bankruptcy context.[206]

Thus, even if a particular divorce obligation is eventually found to be nondischargeable spousal support, the confusion and uncertainty created by the Bankruptcy Code's support/property distinction is expensive and disruptive to divorce obligees. The Code's current treatment of divorce obligations adds further to the complexity and expense associated with divorce by requiring family law attorneys to master the intricacies of

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[204] *See* Chubb et al., *supra* note 199, at 351; White, *supra* note 100, at 17–18, 22 ("Caution being the better part of valor, the wise family law lawyer will seek leave of the bankruptcy court before proceeding with any action that arguably violates the automatic stay."); Zeisler, *supra* note 73, § 44.04[4]–[5], at 44-9 to -11 ("[T]he practitioner should not take the risk of proceeding in a state court when the automatic stay is in effect. Determination of the dischargeability issue in the Bankruptcy Court [sic] is the only certain way of avoiding possible sanctions."). The nondebtor spouse may also litigate the dischargeability issue in state court, if the debtor does not object to this forum. *See* Scheible, *Fresh Start*, *supra* note 3, at 625–26.

[205] *See* Zeisler, *supra* note 73, § 44.04[4], at 44-10 to -11 ("Caution is dictated, however, if the practitioner plans to proceed when the automatic stay is in effect. Since one is rarely certain as to what is considered alimony or child support . . . an improper evaluation subjects the non-debtor spouse to serious sanctions."); text accompanying notes 68–101. Indeed, if the bankruptcy court follows the *Calhoun* "present circumstances" approach in determining the dischargeability of divorce obligations, such uncertainty will exist in virtually all cases.

[206] A divorce obligee may elect not to participate in bankruptcy proceedings and instead file a petition in state court to determine the dischargeability of a marital debt. While § 523(c) of the Bankruptcy Code requires that the dischargeability of certain specified debts be determined by the bankruptcy court, marital obligations are not included in that provision. 11 U.S.C. § 523(c); *see also* Scheible, *Fresh Start*, *supra* note 3, at 625. Thus, the dischargeability of marital debts may be determined by state courts, unless the debtor first files a complaint to determine dischargeability in the bankruptcy court. *See* Freeburger & Bowles, *supra* note 68, at 617–18 (suggesting that it would be advantageous to the obligee spouse to seek a determination on dischargeability from the state court that entered the divorce decree); Scheible, *Fresh Start*, *supra* note 3, at 625–26 & n.311. In addressing the dischargeability issue, the state court must apply federal bankruptcy law. *See In re* Marriage of Salisbury, 779 P.2d 878, 881 (Kan. Ct. App. 1989); State *ex rel.* Rough, 710 P.2d 47, 49 (Mont. 1985). Once the state court has made its dischargeability determination, the issue may not be relitigated in federal court. Scheible, *Fresh Start*, *supra* note 3, at 626.

bankruptcy law and to concern themselves with the potential bankruptcy implications of the settlements they negotiate and the judgments they seek.[207] The necessity for such expertise likely increases the costs of adequate divorce representation, and such higher costs further disadvantage financially weaker divorcing spouses.

B. *The Divorce Obligee's Options After Discharge*

A debtor's ability to discharge divorce-related property obligations has serious and often permanent repercussions for the divorce obligee. The discharge of a debt in bankruptcy extinguishes the debtor's liability and forbids creditors from taking any action "to collect, recover or offset any such debt."[208] As a result, once a bankruptcy court has determined that a divorce obligation is dischargeable, a state court is precluded from amending or modifying the divorce decree to reinstate the discharged obligation.[209] Nor may divorcing parties agree in advance, as part of their divorce settlement or decree, to the reinstatement of obligations discharged in bankruptcy.[210]

When a bankruptcy court discharges a disputed divorce award, it often consoles the obligee spouse by suggesting that she return to state court to seek an increase in spousal support.[211] But this consolation is seldom realistic. First, obtaining an increase in spousal support is possible only if the original divorce decree either awarded alimony or expressly reserved

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[207] *See* White, *supra* note 100, at 51 ("The spectre of bankruptcy should haunt the prudent family law attorney when drafting, negotiating, and structuring a dissolution order or marital settlement agreement."); Zeisler, *supra* note 73, § 44.11, at 44-50 ("The matrimonial attorney should consider the impact of a bankruptcy on each decree in order to prevent the loss of assets or the discharge of an obligation.").

[208] 11 U.S.C. § 524(a)(2); *see also* Scheible, *Fresh Start*, *supra* note 3, at 619.

[209] *See* Scheible, *Fresh Start*, *supra* note 3, at 619–20.

[210] *See* United States v. Hampton (*In re* Hampton), 47 B.R. 47, 49 (Bankr. E.D. Ill. 1985) ("Bankruptcy discharge is not subject to contractual negotiation."); Watrous v. George (*In re* George), 15 B.R. 247, 248 (Bankr. N.D. Ohio 1981) ("[Pre-bankruptcy] waivers [are] in conflict with the purposes of the Bankruptcy Code and will be enforceable only if [the debt in question is] found to be in the nature of alimony."); Coakley v. Coakley, 400 N.W.2d 436 (Minn. Ct. App. 1987) (invalidating attempt to waive bankruptcy rights by authorizing court to reopen divorce judgment if husband filed for bankruptcy); *In re* Driscoll, 817 P.2d 702 (Mont. 1991) (invalidating provision in divorce decree prohibiting discharge of divorcing wife's monetary obligation).

[211] *See, e.g.*, Murphy v. Nowac (*In re* Nowac), 78 B.R. 638, 640 (Bankr. D. N.H. 1987); Winders v. Winders (*In re* Winders), 60 B.R. 746, 748 (Bankr. N.D. Iowa 1986); *see also* Zeisler, *supra* note 73, § 44.06[4], at 44-36 (discussing post-bankruptcy modification of support obligations).

jurisdiction to do so.[212] In the absence of such reserved jurisdiction, a state court is generally precluded from granting post-bankruptcy support even where the "property" obligation discharged in bankruptcy was clearly incurred in lieu of alimony.[213] Thus, an economically disadvantaged spouse who agrees to waive alimony in return for a favorable division of marital assets (or liabilities) risks being permanently deprived of the means necessary for her support by a successful bankruptcy filing.[214] Similarly, a spouse who agrees as part of an overall settlement to a non-modifiable support award may be precluded from later seeking an increase in support to offset the elimination in bankruptcy of her partner's other divorce obligations.

Even where a state divorce court retains the authority to modify support in response to an obligor's discharge in bankruptcy, an obligee spouse by no means is assured of obtaining an increase. In most jurisdictions, a party seeking to modify support must demonstrate a substantial and continuing change in circumstances that "[was] not contemplated or provided for in the original [divorce] decree."[215] Obtaining an increase in support is even more difficult in states that have adopted the Uniform Marriage and Divorce Act; in these states, a nondebtor spouse must show "changed circumstances so substantial and continuing as to make the [original support award] unconscionable."[216] Moreover, questions regarding the modification of support are generally committed to the sound discretion of the trial judge, and are reversed only for an abuse of discretion.[217]

While a divorce obligee may argue that her ex-husband's bankruptcy discharge justifies an increase in spousal support,

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[212] *See* Scheible, *Fresh Start*, *supra* note 3, at 620. Since alimony is awarded in only a small percentage of divorces, most non-debtor spouses are likely to be precluded from pursuing this option.

[213] *See, e.g.*, Stolp v. Stolp, 383 N.W.2d 409, 412–13 (Minn. Ct. App. 1986) (holding that where no maintenance was awarded at the time of divorce, court had no jurisdiction later to award maintenance for any purpose); Benavides v. Benavides, 660 P.2d 1017, 1020 (N.M. 1983) (refusing, after husband's successful discharge in bankruptcy, to modify divorce decree under which wife had waived alimony); Scheible, *Fresh Start*, *supra* note 3, at 620–21.

[214] *See* Gold, *supra* note 2, at 473.

[215] CLARK, *supra* note 19, at 660.

[216] UNIF. MARRIAGE & DIVORCE ACT § 316, 9A U.L.A. 147, 489–90 (1987). Eight states have adopted the Uniform Act. *See* 9A U.L.A. 147, 147 (listing states that have adopted Act).

[217] *See* Patterson v. Gartman, 439 So. 2d 171, 173 (Ala. Civ. App. 1983) (stating that modification of support decree based on changed circumstances is within sound discretion of trial court and should be reversed only for plain abuse of discretion); CLARK, *supra* note 19, at 659.

the obligor spouse is likely to respond that his bankruptcy demonstrates a decline in financial circumstances that merits a *reduction* in support.[218] Thus, a divorce obligee who follows the bankruptcy court's advice to seek a support modification in response to her ex-husband's discharge in bankruptcy may risk further eroding—rather than improving—her already precarious financial position.

The reluctance of many state courts to interfere with the "fresh start" objectives of bankruptcy law poses an additional obstacle to the divorce obligee who seeks a post-bankruptcy increase in spousal support. In *Coakley v. Coakley*,[219] for example, the court refused the parties' joint request to reopen a stipulated divorce judgment after the husband's discharge in bankruptcy, finding that the requested relief would deny the husband the fresh start that bankruptcy granted him.[220] Similarly, in *Cohen v. Cohen*,[221] the court refused to include in a divorce decree provisions that would offset the effect of the husband's pre-divorce discharge of his share of community debts.[222] The court reasoned that including such provisions would "'frustrate the intent and purpose of the Federal Bankruptcy Act and thus violate the supremacy clause of the U.S. Constitution.'"[223]

Even if a divorce obligee succeeds in obtaining an increase in spousal support following the discharge of her ex-spouse's other divorce obligations, she will still have incurred the substantial expense and aggravation associated with post-divorce litigation. In addition, such a "successful" divorce obligee will face the often daunting task of enforcing her augmented support award.[224] Ironically, it may well have been precisely these enforcement difficulties that persuaded the obligee spouse to rely

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[218] *See, e.g.*, Deaton v. Deaton, 393 So. 2d 408, 409 (La. Ct. App. 1980) (concluding that husband's personal and corporate bankruptcy, along with other factors, warranted reduction in alimony); Streitz v. Streitz, 363 N.W.2d 135, 138 (Minn. Ct. App. 1985) (stating that bankruptcy is a factor demonstrating material change in circumstances entitling debtor to support reduction); Zeisler, *supra* note 73, § 44.06[4], at 44-36.

[219] 400 N.W.2d 436 (Minn. Ct. App. 1987).

[220] *Id.*

[221] 164 Cal. Rptr. 672 (Cal. Ct. App. 1980).

[222] *Id.*

[223] *Id.* at 674 (quoting trial court).

[224] For a discussion of some of the difficulties associated with enforcing support awards, see CANADIAN INSTITUTE OF LAW RESEARCH AND REFORM, MATRIMONIAL SUPPORT FAILURES: REASONS, PROFILES, AND PERCEPTIONS OF INDIVIDUALS INVOLVED (1981).

initially on property division, rather than alimony, as her primary divorce entitlement.

C. *The Skewing of Divorce Negotiations*

Even if an obligor spouse does not actually file for bankruptcy, the knowledge that some divorce obligations can be discharged is likely to cast a shadow of uncertainty over divorce negotiations. As one recent law review article concluded:

> By careful analysis of [recent case law] the divorce practitioner may glean ideas which, if properly executed, may lead to the settlement agreement or divorce decree emerging from bankruptcy review unscathed. However, there is nothing the divorce practitioner can do in state court at the time the decree is entered to ensure his client that the decree will escape review by the estranged forum of the bankruptcy court.[225]

Indeed, because privately negotiated divorce agreements are particularly vulnerable to recharacterization in bankruptcy,[226] permitting the discharge of any divorce-related debts is likely to undermine the family law objective of encouraging private consensual resolution of financial issues, rather than contested court proceedings.

Permitting the discharge of divorce-related property obligations is also inconsistent with the modern divorce law preference for using property division, rather than alimony, to accommodate the spouses' future needs, wherever practicable. By undermining the certainty and finality of property obligations, bankruptcy law impairs one of their most important features. Indeed, concerns about the possibility of a discharge in bankruptcy may lead family law practitioners to recommend that a dependent spouse seek a support award rather than a property settlement, despite the well-known enforcement difficulties associated with awards of spousal support.[227]

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[225] Freeburger & Bowles, *supra* note 68, at 614–15.

[226] *Id.* at 614; *see also* Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1105 (6th Cir. 1983); Helm v. Helm (*In re* Helm), 48 B.R. 215, 225 (Bankr. W.D. Ky. 1985).

[227] *See* Zeisler, *supra* note 73, § 44.09(1), at 44-46 (suggesting that the nondebtor spouse negotiate greater periodic alimony payments in order to promote nondischargeability, rather than rely on a favorable allocation of joint marital debts). These difficulties include enforcement problems and the possibility of future modification or termination of awards.

Bankruptcy considerations may also discourage financially dependent spouses from seeking or negotiating non-modifiable support arrangements, despite the emerging consensus that compensatory awards for one spouse's contributions to the other's career should not be subject to modification.[228] Since non-modifiability is perceived as a traditional characteristic of property settlements or awards, obligee spouses and their attorneys may fear that precluding modification may lead a bankruptcy court to conclude that the award is not "in the nature of support" or may preclude a state court from later reconsidering "what remains of a settlement agreement after a bankruptcy court has, perhaps, reviewed the agreement and emasculated it."[229] The resulting availability of modification, however, conflicts with the desire for certainty in divorce arrangements and runs counter to the compensatory and restitutionary purposes that underlie many modern support awards.

This conundrum illustrates a more general problem. The Bankruptcy Code's current treatment of divorce obligations allows federal bankruptcy considerations to drive the resolution of state domestic relations disputes. This phenomenon reverses the appropriate relationship between state and federal legal systems in the area of marriage and divorce.[230] State domestic relations law—not federal bankruptcy considerations—should determine how courts and divorcing spouses structure the financial allocations arising out of the dissolution of marriage.

A recent Texas case provides a particularly poignant example of a state court's unsuccessful effort to structure a divorce judgment so as to avoid the harsh effects of a bankruptcy filing. In *Kahn v. Kahn*,[231] a husband moved from Texas to Florida in

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[228] *See supra* note 168 and accompanying text.

[229] Freeburger & Bowles, *supra* note 68, at 616. The same logic would apply to judicially-imposed divorce awards.

[230] Generally, federal law is unconcerned with the law of divorce. As the Supreme Court has stated: "[T]he whole subject of the domestic relations of husband and wife . . . belongs to the laws of the [s]tates, and not to the laws of the United States." Hisquierdo v. Hisquierdo, 439 U.S. 572, 581 (1979) (*quoting In re* Burrus, 136 U.S. 586, 593–94 (1890)). Under the "domestic relations exception" to federal diversity jurisdiction, the federal courts do not have jurisdiction to grant divorces, award alimony, or determine the custody of children, even if the parties are citizens of different states and the required amount in controversy is present. Ankembrant v. Richards, 112 S. Ct. 2206 (1992) (affirming existence of "domestic relations exception" but finding it inapplicable to tort suit brought by divorced mother on behalf of her children against the children's father and his female companion); *see also* CLARK, *supra* note 19, at 414.

[231] 813 S.W.2d 708 (Tex. Ct. App. 1991).

response to his wife's filing for divorce. In violation of a temporary court order, the husband took with him $39,000 in cash, as well as property valued at $20,000. The husband also hid the couple's personal papers and financial records, leaving his wife and two children with little cash, a $2000 monthly mortgage payment, and various marital debts.[232] At the divorce hearing—at which the husband did not appear—the wife testified that her husband had threatened to file for bankruptcy after the completion of divorce proceedings because "he wanted to see her fail."[233] At the close of the hearing, the trial judge granted the wife's request to structure $39,000 of her community property award as lump sum child support, so that the husband could not discharge the obligation in bankruptcy.[234]

The Texas Court of Appeals reversed, finding that the lump sum award constituted an abuse of the trial court's discretion. The appellate court acknowledged that the trial judge's order represented "a sincere, thoughtful effort" to avoid the harsh consequences of a discharge in bankruptcy, but found that a spouse's threat to declare bankruptcy did not meet the statutory "good cause" requirement for ordering lump sum child support.[235] While one can certainly take issue with the Court of Appeals' narrow interpretation of statutory "good cause,"[236] one also must question the efficacy of the federal bankruptcy structure that both gave credence to the husband's threat and necessitated the trial judge's creative but misguided exercise of discretion. At the very least, a case like *Kahn* should lead federal policy-makers to consider whether the justifications for allowing the discharge of divorce-related property debts are strong enough to outweigh the potential harmful effects of discharge on the debtor's former spouse and children.

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[232] *Id.* at 708–09.

[233] *Id.* at 709.

[234] *Id.* Texas law precludes divorce courts from granting alimony, although it allows parties to contract for an alimony obligation. *See* Reppy, *supra* note 5, at 3.

[235] *Kahn*, 813 S.W.2d at 708–09. The court concluded: "We are sympathetic to the plight of a former spouse who fears a major portion of her former spouse's obligation to deliver property awarded to her will be discharged in bankruptcy. Unfortunately, we can find no authority for ordering lump sum child support to avoid this eventuality." *Id.* at 709.

[236] The Court of Appeals noted that an obligee's misconduct could justify a lump sum child support award but refused to characterize the husband's threat of bankruptcy as such misconduct. *Id.* at 710.

IV. Proposed Bankruptcy Code Amendment

A. *The Rationale for Making All Divorce Obligations Nondischargeable*

Establishing that support and property awards are functionally—and often formally—indistinguishable strongly suggests that they should be treated similarly for purposes of bankruptcy discharge. The question remains, however, whether both types of obligations should be exempted from discharge, as only support obligations are now, or whether both support and property awards should be discharged in the same manner as ordinary commercial debts.

The former solution is preferable. Strong family law considerations support extending the current marital support exemption to cover divorce-related property obligations. Moreover, such an extension would not unduly infringe on the "fresh start" policy that underlies modern bankruptcy law. Divorce-related obligations differ in important respects from virtually all other dischargeable liabilities. In addition, none of the reasons commonly given to support a general right to discharge applies to divorce-related obligations.

1. Family Law Considerations

The fundamental purpose of divorce-related financial adjustments—whether they are denominated property divisions or support awards—is to achieve an equitable sharing of the economic gains and losses attributable to a marriage.[237] This means that where a divorce award is the result of a contested adjudication, a state court has determined that the obligation is appropriate and equitable, at least as between the divorcing parties. Even where a divorce obligation is the product of private negotiation, rather than adjudication, it is likely to represent both an equitable and a considered commitment. As family law scholars have emphasized, divorce agreements are negotiated "in the shadow of the law"; the law's view of what constitutes an equitable sharing of benefits and burdens plays a central role

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[237] *See* Clark, *supra* note 19, at 594; Krauskopf, *supra* note 1, at 256.

in negotiating and structuring these agreements.[238] Allowing a bankruptcy court to restructure the ex-spouses' financial relationship, by extinguishing any of a debtor's divorce obligations, thus directly undermines the family law objective of apportioning equitably the gains and losses associated with a marriage.

Allowing debtors to discharge divorce obligations also undermines a second important objective of modern domestic relations law: to resolve as definitely and as permanently as possible at the time of divorce the financial relationship of divorcing couples. This preference for certainty and finality is often expressed as the desire for a "clean break" between the spouses.[239] But a complete termination of the couple's financial relationship is not necessary to achieve these goals. A divorce judgment that orders one spouse to pay the other a set amount of money over a definite period, or that mandates an equal sharing of the parties' post-divorce incomes for a set number of years after divorce, also provides the parties with a considerable degree of certainty about their future financial relationship. Allowing a bankruptcy court to redefine that relationship, by discharging all or part of one spouse's divorce obligations, significantly reduces the degree of certainty and security that divorce judgments and settlements can provide.

On a more theoretical level, the Bankruptcy Code's current treatment of divorce obligations conflicts with the modern conception of marriage as a "partnership between co-equals" rather than a support/dependency relationship.[240] Both the widespread adoption of equitable distribution and the modern preference for property division over alimony reflect this change in the prevailing conception of marriage.[241] By preserving only those

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[238] Robert H. Mnookin & Lewis Kornhauser, *Bargaining in the Shadow of the Law: The Case of Divorce*, 88 YALE L.J. 950 (1979); *cf.* Jana B. Singer & William L. Reynolds, *A Dissent on Joint Custody*, 47 MD. L. REV. 497, 515–17 (1988) (discussing effect of custody rules on divorce negotiations).

[239] *See, e.g.*, Herma Hill Kay, *Appraisal of California's No-Fault Divorce Law*, 75 CAL. L. REV. 291, 313 (1987) ("[N]o-fault philosophy . . . seeks to achieve a clean break between spouses to enable each to begin a new life."); Robert J. Levy, *A Reminiscence About the Uniform Marriage and Divorce Act—and Some Reflections About Its Critics and Its Policies*, 1991 B.Y.U. L. REV. 43, 72 (referring to "clean break policy" emphasized by Uniform Marriage and Divorce Act). As Mary Ann Glendon has pointed out, the idea of a clean financial break between divorcing spouses is "wholly unrealistic" in divorces involving minor children, which account for approximately three-fifths of all divorces in the United States. MARY ANN GLENDON, ABORTION AND DIVORCE IN WESTERN LAW 93 (1987).

[240] Carol S. Bruch, *Of Work, Family Wealth, and Equality*, 17 FAM. L.Q. 99, 101 (1983).

[241] *See* Throne, *supra* note 137, at 194–99.

divorce obligations that conform to traditional notions of dependency and support—and extinguishing those that rest on more modern partnership principles—federal bankruptcy law reflects and perpetuates an inaccurate and outdated view of marriage.

Rejecting the traditional view of marriage in favor of a more modern partnership vision does not entail endorsement of marriage as a business partnership. Unlike business partners, spouses and prospective spouses do not deal with each other for a limited, commercial purpose, nor do they seek to maximize profit.[242] Indeed, one of the primary characteristics of family behavior is a willingness to sacrifice individual self-interest for the benefit of other family members.[243] The modern law governing post-divorce financial obligations is designed, in part, to ensure that one spouse does not benefit unjustly from the other's family-oriented sacrifices and contributions.[244] Moreover, marriage is critical to self-identity in a way that most business relationships are not.[245]

Society, too, has a greater interest in imposing and enforcing financial commitments arising out of marriage than it does in enforcing purely commercial obligations. Spouses are both particularly dependent upon and particularly vulnerable to each other.[246] Moreover, marriage remains a primary arena for the care and nurturing of children. Society thus has a heightened interest in creating and enforcing obligations that ensure equity between divorcing spouses and that protect children's financial interests when a marital relationship dissolves.[247]

2. Bankruptcy Considerations in Support of Discharge

Because of these important differences between divorce-related obligations and ordinary commercial debts, refusing gen-

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[242] *See* Ellman, *supra* note 149, at 33–40 (criticizing application of partnership principles to marriage); Rutherford, *supra* note 158, at 555 (contrasting marriage with business partnerships).

[243] *See generally* Susan Westerberg Prager, *Sharing Principles and the Future of Marital Property Law*, 25 UCLA L. REV. 1, 6–11 (1977); Judy Areen, *A Need For Caring*, 86 MICH. L. REV. 1067, 1072–78 (1988) (book review).

[244] *See, e.g.*, Ellman, *supra* note 149, at 49–52; Krauskopf, *supra* note 1, at 256.

[245] *See* Martha Minow, *Identities*, 3 YALE J.L. & HUMAN. 315, 326–29 (1991); Carol Weisbrod, *Divorce Stories: Readings, Comments and Questions on Law and Narrative*, 1991 B.Y.U. L. REV. 143, 194.

[246] *See* Schneider, *supra* note 159, at 245.

[247] *See* June Carbone, *Rethinking Marriage: Feminist Ideology, Economic Change, and Divorce Reform*, 65 TUL. L. REV. 953, 1007–09 (1991); Schneider, *supra* note 159, at 257.

erally to allow the discharge of divorce-related obligations would infringe only minimally on the legitimate goals of bankruptcy law. In particular, the essential economic and jurisprudential rationales offered to support a general right to discharge are not persuasive when applied to obligations assumed or imposed in connection with divorce.

In a seminal article entitled *The Fresh-Start Policy in Bankruptcy Law*, Professor Thomas H. Jackson offers several justifications for a non-waivable right of discharge.[248] First, Jackson asserts that a non-waivable right of discharge protects individuals from their own impulsive decisions to overconsume credit, by encouraging creditors to monitor borrowing more closely.[249] Jackson claims that this sort of legal rule, and the restrictions on contractual freedom that it entails, accord with the result that hypothetical individuals would reach behind a Rawlsian veil of ignorance: "If the members of society had gathered together before the fact and had anticipated the human tendency toward impulsive behavior, they would have devised a rule that denied them the opportunity to behave impulsively in the future."[250] Jackson buttresses this argument by drawing on psychological evidence which suggests that, because of flaws in the way people process information, individuals consistently underestimate future risks, including the risks that their current consumption imposes on their future well-being.[251] Because of the difficulties of compensating for these failures on an individual basis, a socially mandated non-waivable right of discharge may be desirable.[252] Finally, Jackson argues that a non-waivable right of discharge may be justified because refusing to allow discharge might impose unacceptable costs on a wide range of third parties, starting with the debtor's family.[253]

None of these justifications supports the discharge of divorce-related obligations, however. Obligations owed to a former spouse are not incurred impulsively, but are accumulated gradually and progressively, over the course of a marriage. Moreover, these obligations generally result not from a one-time encounter or decision to consume, but from a series of interre-

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[248] Thomas H. Jackson, *The Fresh-Start Policy in Bankruptcy Law*, 98 HARV. L. REV. 1393 (1985).
[249] *Id.* at 1408–10.
[250] *Id.* at 1410.
[251] *Id.* at 1410–13.
[252] *Id.* at 1414–15.
[253] *Id.* at 1419.

lated and considered commitments. Even if one viewed divorce-related obligations as originating at the time of divorce, rather than as accumulating during marriage, the assumption of those obligations is not likely to result from impulsive behavior. Divorce obligations are either imposed by a court after careful consideration of both sides' positions or are the product of private negotiations in which the parties are represented by counsel.[254] Thus, divorce-related obligations are neither the result of impulsive decisions to overconsume, nor the product of accidental encounters between strangers.

Moreover, spouses and potential spouses are not likely to respond to a rule allowing the discharge of divorce obligations by becoming more wary about extending credit. Unlike most commercial creditors, spouses generally do not decide to "invest" in their partners based on economic factors.[255] Moreover, to the extent that allowing discharge of divorce obligations might affect marital behavior, it is likely to do so in ways that many would view as socially undesirable. Economically rational spouses who know that they cannot count on the security of financial obligations imposed at divorce may well decide to maximize their individual earning capacities rather than investing heavily in their families.[256] Such conduct would guard against financial vulnerability in the (not unlikely) event of divorce followed by an ex-spouse's bankruptcy.

Professor Jackson's final concern—the effects of a discharge rule on the debtor's family and other third parties—argues against the dischargeability of divorce obligations. The third parties most directly affected by the debtor's bankruptcy are likely to be his ex-spouse and children, and the effect on them of allowing discharge of divorce obligations is likely to be extremely injurious.[257] Thus, to the extent that discharge rules are

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[254] Divorcing parties are particularly likely to be represented by counsel where there is substantial property to divide or where at least one spouse has substantial earning capacity.

[255] *See generally* Schneider, *supra* note 159.

[256] *Cf.* Ellman, *supra* note 149, at 46–53 (making a similar argument to justify the availability of alimony upon divorce).

[257] If the debtor has remarried, his new spouse (and any children born of the new marriage) would probably benefit from the discharge of the debtor's divorce-related obligations. Generally, however, the assumption of new family responsibilities does not adequately justify avoiding financial commitments to a former spouse or children. *See, e.g.*, Williams v. Williams, 444 A.2d 977 (Me. 1982) (holding that ex-husband's remarriage did not justify reduction in alimony obligation); Christensen v. Christensen, 628 P.2d 1297 (Utah 1981). *But see* Berg v. Berg, 359 A.2d 354 (R.I. 1976) (stating that where obligor's adoption of second wife's children impaired his financial ability to

justified by their ability to minimize financial hardship to persons with a close relationship to the debtor, bankruptcy law should prohibit, rather than permit, the discharge of divorce-related obligations.

Several commentators have recently attempted to provide an alternative justification for discharge in bankruptcy, grounded in a natural law theory of morality.[258] These theories also recognize a clear distinction between divorce-related financial obligations and ordinary consumer debts. In particular, these theorists acknowledge that the same values of human dignity, autonomy, and reciprocity that provide moral support for a general right of bankruptcy discharge also support an exception to that right for obligations arising out of family relationships.[259]

Nor would exempting all divorce-related obligations from discharge unduly compromise the "fresh start" policy that lies at the heart of modern bankruptcy law. Bankruptcy law's "fresh start" rationale is most compelling in the context of commercial and consumer transactions. For example, in the Supreme Court case that is often cited as the fount of the "fresh start" policy, the Court explained that a prime purpose of bankruptcy law

> is to "relieve the honest debtor from the weight of oppressive indebtedness and permit him to start afresh free from the obligations and responsibilities consequent upon business misfortunes." This purpose of the act has been again and again emphasized by the courts as being of public as well as private interest, in that it gives to the honest but unfortunate debtor . . . a new opportunity in life and a clear field for

provide for the needs of his former family, court should consider modification of alimony and child support obligations).

[258] *E.g.*, Richard E. Flint, *Bankruptcy Policy: Toward a Moral Justification for Financial Rehabilitation of the Consumer Debtor*, 48 WASH. & LEE L. REV. 515 (1991); Karen Gross, *The Debtor as Modern Day Peon: A Problem of Unconstitutional Conditions*, 65 NOTRE DAME L. REV. 165, 196, 200–01 (1990) (suggesting that the availability of discharge preserves non-instrumental values of "autonomy, reciprocity and equality"); *cf.* Anthony T. Kronman, *Paternalism and the Law of Contracts*, 92 YALE L.J. 763, 785 (1983) ("One reason for giving the debtor a fresh start is to counteract the self-hatred he may feel, having mortgaged his entire future in a series of past decisions he now regrets.").

[259] Flint, *supra* note 258, at 539 ("The moral responsibility of the debtor to provide economic support for his family is beyond question, and the exception [to discharge for family obligations] can be explained under the moral theory posited here as a response to the humanitarian needs of the family. The underlying ethical commitment to one's family was recognized by the courts even before the Act was amended in 1903 to specifically except such obligations from discharge."); Gross, *supra* note 258, at 189 (recognizing that, despite constitutional and statutory prohibitions on peonage, "[p]arents can be required to support their children and spouses can be compelled to work to pay alimony").

> future effort, unhampered by the pressure and discouragement of preexisting debt.[260]

This passage underscores the fact that the "fresh start" policy in bankruptcy law is designed primarily to relieve overburdened debtors from obligations incurred in their role as consumers and commercial beings.[261] It is in this context that the "honest but unfortunate" debtor is entitled to a "new opportunity" and a "clear field for future effort." Put more philosophically, the "fresh start" policy is primarily designed to allow a debtor to avoid the onerous financial consequences of his honest but unwise participation in the market by surrendering any remaining fruits of his market encounters and emerging with his personal core intact, free to resume his role as a productive economic actor.

As the Supreme Court's early marital exemption cases demonstrate, this policy was never meant to release a debtor from obligations imposed or assumed as a result of his participation in a marriage.[262] To the extent that a "fresh start" is warranted in the matrimonial context, state divorce law provides that opportunity.

B. *The Statutory Proposal*

The foregoing analysis suggests that Congress should amend section 523(a)(5) of the Bankruptcy Code to eliminate the statutory dichotomy between divorce-related support and property obligations and should exempt from discharge in bankruptcy all obligations to or for the benefit of a spouse, former spouse, or

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[260] Local Loan Co. v. Hunt, 292 U.S. 234, 244 (1934) (quoting Williams v. U.S. Fidelity & Guar. Co., 236 U.S. 549, 554–55 (1915)). Courts and commentators who quote from *Hunt* often delete the Court's reference to business misfortunes.

[261] For general discussions of the "fresh start" policy, see ARNOLD B. COHEN, BANKRUPTCY, SECURED TRANSACTIONS, AND OTHER DEBTOR-CREDITOR MATTERS 182 (1981); THOMAS H. JACKSON, THE LOGIC AND LIMITS OF BANKRUPTCY LAW 225–52 (1986); Douglass G. Boshkoff, *Limited, Conditional, and Suspended Discharges in Anglo-American Proceedings*, 131 U. PA. L. REV. 69 (1982); Karen Gross, *Preserving a Fresh Start for the Individual Debtor: The Case for Narrow Construction of the Consumer Credit Amendments*, 135 U. PA. L. REV. 59 (1991); Jackson, *supra* note 248.

[262] *See* Wetmore v. Markoe, 196 U.S. 68, 77 (1904) ("The bankruptcy law should receive such an interpretation as will effectuate its beneficent purposes and not make it an instrument to deprive dependent wife and children of the support and maintenance due them from the husband and father, which it has ever been the purpose of the law to enforce."). While important changes have occurred in both the precise content of marital obligations and their gender-based derivation, this ethical principle remains compelling.

child of the debtor incurred in connection with marriage, divorce, or separation. To accomplish this goal, Congress should amend section 523(a) of the Bankruptcy Code to read as follows:

> .... (a) A discharge [in bankruptcy] does not discharge an individual debtor from any debt . . .
>
> (5) to or for the benefit of a spouse, former spouse, or child of the debtor
>
> (A) for alimony to, maintenance for, or support of such spouse or child, in connection with
>
> (i) a separation agreement, divorce decree, or other order of a court of record;
>
> (ii) a determination made in accordance with State or territorial law by a governmental unit; or
>
> (iii) a property settlement agreement; or
>
> (B) for any obligation assumed or imposed in connection with a separation agreement, divorce decree, or property settlement agreement;
>
> except to the extent such debt is assigned to another entity, voluntarily, by operation of law, or otherwise (other than debts assigned pursuant to section 402(a)(26) of the Social Security Act, or any such debt which has been assigned to the Federal Government or to a state or any subdivision of a State).[263]

This amendment would significantly reduce the tension between divorce and bankruptcy law and would eliminate the specter of federal bankruptcy proceedings reallocating the equitable apportionment of marital gains and losses mandated by a state court's divorce judgment. Elimination of the support/property distinction would also ensure that bankruptcy considerations would not drive the negotiation and settlement of state domestic relations disputes. Finally, the amendment would discourage divorce obligors from using (or threatening to use) bankruptcy as a vehicle for extinguishing an ex-spouse's divorce entitlements, while at the same time preserving bankruptcy's tradi-

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[263] This proposed amendment is similar to the proposed "Property Settlement Integrity Act of 1990," introduced by Representative Henry J. Hyde (R-Ill.) on March 5, 1991. H.R. 1242, 102d Cong., 1st Sess. (1991).

tional objective of giving the "honest but unfortunate debtor" a fresh financial start.

C. *Application of the Amended Statute*

1. In General

The proposed amendment would obviate the need for bankruptcy courts to determine whether a given divorce obligation is a support award or a property division. It would thus eliminate the need for bankruptcy courts to inquire into the "intent" of state divorce judges or divorcing spouses, or to probe ex-spouses' past or current financial situations. Moreover, under the proposed amendment, divorce obligees would no longer be forced to relitigate—in an often unfriendly federal forum—the very issues of need and economic capacity previously determined in divorce proceedings. Instead, the only requirements for nondischargeability would be that the obligation was incurred in connection with a divorce or marital separation and that it was to or for the benefit of a spouse, ex-spouse or child of the debtor.[264] The remainder of this section examines the effect of the proposed amendment on several recurring types of divorce obligations.

2. Attorneys' Fees and Divorce Expenses

The amended exemption would prevent a debtor from discharging an agreement or decree-imposed obligation to pay an ex-spouse's divorce-related attorneys' fees or other litigation expenses. Unlike the situation under current law, there would be no need to determine whether the obligation to pay the attorneys' fees or expenses was actually in the nature of support.[265] Nor would the fact that payment was to be made directly to the attorney or another third party affect the dischargeability

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[264] The proposed amendment would preserve the nondischargeability of all court-ordered child support obligations, regardless of whether they were imposed in connection with divorce or marital separation.

[265] Although most courts have held that a debtor's obligation to pay an ex-spouse's divorce-related attorneys' fees is nondischargeable spousal support, they have often allowed discharge of liability for other divorce-related expenses. *See, e.g.*, Eisen v. Linn (*In re* Linn), 38 B.R. 762, 763 (Bankr. 9th Cir. 1984) (holding that psychologist's fees incurred in connection with custody hearing were dischargeable); Scheible, *Defining Support*, *supra* note 3, at 44–45 n.251.

inquiry, since the amended statute would exempt from discharge all divorce-related obligations to or for the benefit of a former spouse or child.

3. Payment of Future Expenses

The expanded exemption would also apply where a divorcing spouse has agreed or been ordered to make specified future payments to third parties for the benefit of his ex-spouse or children. Such divorce-related obligations often include medical, educational, and insurance expenses, as well as specified living expenses, such as rent or utility payments.[266] Under the current Bankruptcy Code, the treatment of such prospective third party obligations is inconsistent. Read literally, the language of section 523(a) appears to require that, to be nondischargeable as a support obligation, a debt must be owed directly to a spouse, former spouse, or child of the debtor, rather than to a third party.[267] Only a small minority of courts, however, has adopted this strict statutory interpretation.[268] A majority of courts have reasoned instead that Congress intended support obligations to be nondischargeable regardless of whether they were payable directly to the spouse or child.[269] These courts generally disregard the

[266] *See* Scheible, *Defining Support*, *supra* note 3, at 41.

[267] Section 523(a)(5) of the Bankruptcy Code exempts from discharge any debt "to a spouse, former spouse or child of the debtor, for alimony to, maintenance for, or support of such spouse or child." 11 U.S.C. § 523(a)(5). In addition, the House Report accompanying the Bankruptcy Reform Act of 1978 provides:

> Paragraph (5) excepts from discharge debts to a spouse, former spouse, or child of the debtor for alimony to, maintenance for, or support of, the spouse or child. This language, in combination with the repeal of section 656(b) of the Social Security Act (43 U.S.C. § 656(b)) by section 327 of the bill, will apply to make nondischargeable only alimony, maintenance, or support owed directly to a spouse or dependent.

H.R. REP. No. 595, 95th Cong., 1st Sess. 364 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320; *see also* S. REP. No. 989, 95th Cong., 2d. Sess. 79 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5865.

[268] *See* Fritz v. Daiker (*In re* Daiker), 5 B.R. 348 (Bankr. D. Minn. 1980) (holding that debts owed to Employees Credit Union, Master Charge, and a medical center were dischargeable because the payments were not made directly to former spouse); White, *supra* note 100, at 35–36. In addition, some courts have viewed such obligations as support debts that have been assigned to a third party (the creditor), thus rendering them dischargeable under 11 U.S.C. § 523(a)(5)(A). *See, e.g.*, Dirks v. Dirks (*In re* Dirks), 15 B.R. 775, 779 (Bankr. D.N.M. 1981). Commentators have generally criticized these decisions. *See, e.g.*, Freeburger & Bowles, *supra* note 68, at 591 n.16.

[269] *See* Long v. Calhoun (*In re* Calhoun), 715 F.2d 1103, 1106–07 (6th Cir. 1983); Pauley v. Spong (*In re* Spong), 661 F.2d 6, 9–10 (2d Cir. 1981); White, *supra* note 100, at 39. The legislative history supports this interpretation. Commenting on the 1978 Bankruptcy Code shortly before its passage, Rep. Don Edwards (D-Cal.) stated that:

> If the debtor has assumed an obligation of the debtor's spouse to a third party in connection with a separation agreement, property settlement agreement, or

fact that the actual recipient of the payment will be someone other than a spouse or child and proceed directly to the question of whether the underlying obligation is in the nature of alimony, maintenance, or support.[270]

By prohibiting the discharge of all divorce-related obligations to or for the benefit of an ex-spouse or child, the amended statute would make clear that a divorce obligation is not dischargeable merely because someone other than an ex-spouse or child actually receives payment.[271] Moreover, because the amendment would prohibit the discharge of property (as well as support) obligations, bankruptcy courts would no longer need to inquire whether a particular obligation to pay a family member's future expenses was actually for the purpose of support.

4. Assumption of Joint Marital Debts

The amended statute would also alter the bankruptcy treatment of divorce obligations arising out of one spouse's assumption of debts incurred jointly during marriage. As others have recognized, such an assumption of liability actually involves two separate obligations: the underlying obligation to the third-party creditor and the obligation to the former spouse, assumed in connection with divorce, to accept full responsibility for the

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> divorce proceeding, such debt is dischargeable to the extent that payment of the debt by the debtor is not actually in the nature of alimony, maintenance, or support of debtor's spouse, former spouse, or child.

124 CONG. REC. 32,399 (1978) (statement of Rep. Don Edwards); *see also* S. REP. No. 989, 95th Cong., 2d. Sess. 79 (1978), *reprinted in* 1978 U.S.C.C.A.N. 5787, 5865 ("This provision will, however, make nondischargeable any debts resulting from an agreement by the debtor to hold the debtor's spouse harmless on joint debts, to the extent that the agreement is in payment of alimony, maintenance, or support of the spouses . . . ."); H.R. REP. No. 595, 95th Cong., lst Sess. 364 (1977), *reprinted in* 1978 U.S.C.C.A.N. 5963, 6320.

[270] *See* Newkirk v. Thomas (*In re* Thomas), 21 B.R. 571 (Bankr. E.D. Pa. 1982) (holding that mortgage payments assumed under property settlement were nondischargeable); Growney v. Growney (*In re* Growney), 15 B.R. 849 (Bankr. W.D.N.Y. 1981) (holding nondischargeable medical and dental expenses for children, although not payable directly to wife or children); Lineberry v. Lineberry (*In re* Lineberry), 9 B.R. 700 (Bankr. W.D. Mo. 1981) (holding that debtor's obligation to pay insurance on his own life constitutes support); Scheible, *Defining Support*, *supra* note 3, at 41–42.

[271] As under current law, a divorce-related obligation would be dischargeable to the extent that it had actually been assigned (i.e., transferred) to another entity (other than a governmental entity). *See* 11 U.S.C. § 523(a)(5). The test of whether a debt has been assigned under § 523(a)(5) is whether the former spouse or children of the debtor receive any benefit from the payment of the debt. Stranathan v. Stowell, 15 B.R. 223, 226 (Bankr. D. Neb. 1981); *see also* Freeburger & Bowles, *supra* note 68, at 589 n.12; Scheible, *Defining Support*, *supra* note 3, at 40–41.

third-party debt.[272] This latter obligation is often formalized through the vehicle of a "hold harmless" agreement between the debtor and his former spouse.[273]

Current bankruptcy doctrine generally treats the third-party and spousal obligations as inseparable.[274] If the debtor's "hold harmless" obligation to his former spouse is "in the nature of support," then both the "hold harmless" obligation and the underlying third-party debt are nondischargeable.[275] If, by contrast, a debtor's assumption of a joint marital debt lacks the essential characteristics of support, then both the underlying liability to the third-party creditor and the debtor's obligation to his former spouse are discharged.[276]

The proposed amendment would separate these two obligations for purposes of determining dischargeability. It would

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[272] *See Calhoun*, 715 F.2d at 1106 n.4 ("There are two distinct obligations involved in an agreement to assume former joint marital debts—the underlying debt owed to the mutual creditor and the obligation owed directly to the former spouse to hold the spouse harmless on that underlying debt.").

[273] *See id.* at 1105–06; Zeisler, *supra* note 73, § 44-45.

[274] A few bankruptcy courts have analyzed these obligations separately under the current Bankruptcy Code. These courts have held that even where a debtor's assumption of joint marital obligations is appropriately characterized as support, § 523(a) does not render nondischargeable the underlying obligation to the third-party creditor, but only the obligation to hold the former spouse harmless from the payment of the underlying debt. *See* Kircher v. Lord (*In re* Lord), 93 B.R. 678 (Bankr. E.D. Mo. 1988); Smith v. Smith (*In re* Smith), 42 B.R. 628 (Bankr. E.D. Mo. 1984). The court in Telgmann v. Maune (*In re* Maune), 133 B.R. 1010, 1014 (Bankr. E.D. Mo. 1991), disapproved of this analysis.

[275] *See, e.g., Maune*, 133 B.R. at 1014. In determining the dischargeability of these obligations, most courts focus on whether payment of the assumed debt is necessary for the nondebtor spouse's support. *See, e.g.*, Yeates v. Yeates (*In re* Yeates), 807 F.2d 874 (10th Cir. 1986); Williams v. Williams (*In re* Williams), 703 F.2d 1055 (8th Cir. 1983); Lewis v. Lewis (*In re* Lewis), 39 B.R. 842 (Bankr. W.D.N.Y. 1984). Some courts, however, require that the original third-party debt be one for necessary goods and services. Under this analysis, if the underlying obligation was not for basic needs, then the debtor's subsequent assumption of liability is dischargeable, regardless of the effect of discharge on the nondebtor spouse's current support needs. *See* Erler v. Erler (*In re* Erler), 60 B.R. 220 (Bankr. W.D. Ky. 1986) (holding husband's agreement to indemnify wife for contingent joint tax liability dischargeable because tax liability was not in the "nature" of "daily necessities"); Gold, *supra* note 2, at 484–86. Moreover, where the underlying obligation is secured by property which has been transferred to the debtor spouse, a court is likely to characterize the debtor's assumption of liability as a dischargeable property settlement. *See* Malone v. Hackworth (*In re* Hackworth), 27 B.R. 638 (Bankr. S.D. Ohio 1982).

[276] *See, e.g.*, Stout v. Prussel, 691 F.2d 859, 861 (9th Cir. 1982) (holding that obligation of debtor to hold former wife harmless for a loan was dischargeable because the hold harmless clause was included in order to "equalize the division of community property"); Morgan v. Battaglia (*In re* Battaglia), 44 B.R. 420, 421 (Bankr. D. Del. 1984) (concluding that obligation to pay marital debts was dischargeable because the debtor assumed the obligation in return for the wife's interest in the family home rather than to enable wife to support herself); *Hackworth*, 27 B.R. at 639 (holding that obligation arising from the assumption of liability for a loan, pursuant to a property settlement, was dischargeable even though discharge transferred liability to the ex-wife).

make nondischargeable all divorce-related "hold harmless" obligations, regardless of whether a federal court would characterize these obligations as support awards or property divisions. A debtor's obligation to indemnify his former spouse for debts incurred jointly during marriage would therefore survive bankruptcy in all cases. The same debtor, however, would be permitted to discharge his underlying obligation to the third-party creditor, assuming that discharge was not precluded by other parts of the Bankruptcy Code. Thus, the fact of divorce would no longer preclude a debtor from discharging ordinary commercial or consumer debts that he would have been able to extinguish had he remained married.

There are sound reasons for bankruptcy law to separate these two aspects of a spouse's assumption of joint marital debts. Unlike the debtor's "hold harmless" obligation to his former spouse, the underlying debt to the third-party creditor was incurred independently of the divorce and would have been dischargeable had the debtor remained married. In effect, refusing to permit discharge once divorce has intervened penalizes the debtor for dissolving his marriage. Moreover, exempting from discharge the underlying third-party commercial obligation gives the third-party creditor a privileged status not granted to other unsecured commercial creditors.[277]

Permitting a divorced debtor to discharge such third-party obligations also alleviates many of the concerns that led Congress in 1978 to reject the Bankruptcy Commission's proposal to make marital property obligations nondischargeable. Those who opposed the Commission's proposal were particularly concerned about the effect of an expanded marital exemption on a debtor's ability to discharge obligations to third-party creditors.[278] Indeed, these opponents argued vigorously that preventing a divorced husband from discharging liability for debts

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[277] *See* J. Joseph Cohen, Note, *Congressional Intent in Excepting Alimony, Maintenance, and Support from Discharge in Bankruptcy*, 21 J. FAM. L. 525, 542 (1983); Joan Kingsly Gottesman, Note, *Reconciling Bankruptcy's Fresh Start Policy with Marital Obligations*, 49 BROOK. L. REV. 777, 784–87 (1983) (discussing Congress's desire, in making marital support obligations nondischargeable, to avoid creating unintended beneficiaries such as unsecured creditors).

[278] *See 1977 Hearings*, *supra* note 52, at 688 (statement of Judge Lee) ("The language of the Senate Bill [exempting property settlements from discharge] will make it possible for lawyers to subvert the alimony exception to discharge simply by providing in the property settlement agreement that certain debts shall be paid by the husband."); Gottesman, *supra* note 277, at 784–87.

incurred jointly during marriage would hinder his ability to support a former spouse and children.[279]

The debtor's divorce-created obligation to hold his former spouse harmless for debts incurred jointly during marriage stands on a very different footing: but for the couple's divorce, this obligation would not exist in legal form. Therefore, under the amended statute, this intra-family aspect of a debtor's assumption of joint marital debts would be nondischargeable in bankruptcy, regardless of whether a bankruptcy court would classify the obligation as in the nature of support.

Of course, the nondischargeability of the debtor's "hold harmless" obligation to his former spouse would not stop the third-party creditor from proceeding against the former spouse, since she would still be liable on the underlying debt.[280] The nondebtor spouse, however, could then proceed against the debtor on his undischarged "hold harmless" agreement. The debtor would be liable to his former spouse for the amount of the debt he had agreed to assume, as well as any additional costs the nondebtor spouse had incurred as a result of the creditor's debt collection efforts.[281] Even where the divorce decree or agreement lacked an express "hold harmless" provision, the former spouse could seek relief against the debtor for reneging on his contractual or decree-incorporated obligation to assume liability for the joint debts in question.[282] Ensuring the survival of the debtor's obli-

[279] *See 1977 Hearings*, *supra* note 52, at 686 ("In most instances the husband will not be able to make alimony or child maintenance payments and also pay all the debts of the parties."); *1976 Hearings*, *supra* note 50, at 1308 (letter from Judge Lee to Rep. Drinan). For a detailed discussion of this testimony, see *supra* notes 51–56 and accompanying text.

[280] *See* Scheible, *Defining Support*, *supra* note 3, at 42. This would be true, however, even in the absence of a bankruptcy filing, since the third-party creditor would not be bound by a "hold harmless" agreement between the spouses and could therefore elect to proceed against either spouse, regardless of the existence of a such an agreement.

[281] *See id.* at 43 n.239. This bifurcated approach may cause hardship in cases where the debtor's continued payment of joint obligations is necessary to assure his former family an uninterrupted flow of support. *Id.* However, the same potential for hardship in these cases exists under the current Bankruptcy Code since, by filing for bankruptcy, a debtor automatically suspends all collection efforts by creditors. *See supra* notes 199–203 and accompanying text (discussing automatic stay provisions). Moreover, although proceeding separately against the debtor imposes costs on a divorce obligee, these costs may well be less than the costs associated with litigating the dischargeability issue under the current Bankruptcy Code. This is especially likely to be true in states that have relatively generous monetary limits for small claims filings.

[282] A number of bankruptcy courts have held that a debtor's assumption of certain joint marital debts itself implies an agreement to indemnify the former spouse from liability. *See, e.g.*, Lewis v. Lewis (*In re* Lewis), 39 B.R. 842 (Bankr. W.D.N.Y. 1984); Jensen v. Jensen (*In re* Jensen), 17 B.R. 537 (Bankr. W.D. Mo. 1982). *But see* Lineberry v. Lineberry (*In re* Lineberry), 9 B.R. 700 (Bankr. W.D. Mo. 1981) (concluding that

gation to his former spouse, without regard to its characterization as support, would also act as a deterrent to a debtor who might be contemplating bankruptcy primarily as a way of thwarting an ex-spouse's divorce entitlements.

Thus, in most cases involving the assumption of debts, preserving the debtor's express or implied "hold harmless" obligation to his former spouse, while allowing discharge of the debtor's underlying liability to third-party creditors, will adequately protect the non-debtor divorce obligee.[283] Any additional benefit that could be obtained by precluding discharge of the underlying debt is outweighed by the potential unfairness of denying a debtor relief from ordinary commercial or consumer obligations incurred during marriage merely because of an intervening divorce.[284]

V. CONCLUSION

Recent developments in family law have rendered untenable and unjust the Bankruptcy Code's attempt to distinguish between nondischargeable spousal support awards and dischargeable property obligations. Congress's insistence on preserving the support/property distinction has created a confusing and incoherent body of case law and has inappropriately usurped the states' traditional role in determining the financial consequences of divorce. An ex-spouse's ability to discharge divorce-related property obligations undermines important family law goals; refusing generally to allow such discharge would not

husband's agreement to pay directly to third parties all indebtedness incurred during marriage was not truly a hold harmless agreement). Because the proposed statutory amendment would classify a divorced spouse's express or implied "hold harmless" agreement as a nondischargeable debt, the nondebtor spouse's collection efforts would not violate the Code's prohibition against the collection of debts discharged in bankruptcy.

[283] Indeed, such a bifurcated analysis may, in some cases, benefit divorce obligees by ensuring that changes in the structure of the underlying third-party debt do not affect the debtor's hold harmless obligation to his former spouse. *See, e.g.*, Robinson v. Robinson (*In re* Robinson), 113 B.R. 687, 689 (D. Col.) (concluding that ex-wife's refinancing of second deed of trust, which released husband from liability on original note, did not affect husband's divorce-related "hold harmless" obligation), *aff'd*, 921 F.2d 252 (10th Cir. 1990); Keeran v. Keeran (*In re* Keeran), 112 B.R. 881 (Bankr. N.D. Ohio 1990) (holding that ex-wife's reaffirmation in bankruptcy of debt upon which only ex-husband was formerly liable did not extinguish husband's hold harmless obligation on debt); Swiczkowski v. Neagley (*In re* Swiczkowski), 84 B.R. 487 (Bankr. N.D. Ohio 1988) (holding that debtor's obligation to pay indebtedness due on automobile awarded to ex-wife in divorce was not dischargeable even though the car had been repossessed).

[284] *See* Scheible, *Defining Support*, *supra* note 3, at 43.

substantially interfere with the legitimate goals of bankruptcy law, including the "fresh start" policy that supports a general right to discharge in the commercial and consumer contexts. To ameliorate the shortcomings of the current bankruptcy scheme and restore the integrity of state equitable distribution regimes, Congress should amend the Bankruptcy Code to exempt from discharge all obligations to or for the benefit of a debtor's former spouse or children, assumed in connection with a divorce or marital separation.

ESSAY

RECALIBRATING THE CIVIL JUSTICE REFORM ACT

CARL TOBIAS*

Civil justice reform has become increasingly controversial, with some observers touting the concept as the best hope for the federal courts, and others criticizing the idea as an empty gesture that could well increase delay and expense in civil litigation. Vice President Dan Quayle and the American Bar Association ("ABA") have battled over the issue, with the ABA President characterizing the reform as too important to leave to the government.

In 1990, Congress enacted the Civil Justice Reform Act ("CJRA"), a measure which could substantially change the nature of federal civil litigation.[1] One aspect of the CJRA that provides evidence respecting the progress of civil justice reform is the civil justice expense and delay reduction plans issued in late 1991 by the thirty-four federal district courts which the Judicial Conference of the United States designated as Early Implementation District Courts ("EIDCs").

Congress is currently attempting to assess the reforms included in these plans, which constitute the initial significant step in implementing the CJRA. By some oversight, Congress has not invited me to testify. Indeed, Congress has failed even to schedule a hearing, despite the growing controversy over civil justice reform. I, therefore, must content myself with this Essay.[2]

The Essay first briefly examines the requirements of the Civil Justice Reform Act of 1990 and then analyzes statutory implementation in the federal districts which have attained EIDC status. This evaluation finds that the early reform efforts, while

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* Professor of Law, University of Montana. B.A., Duke University, 1968; LL.B., University of Virginia Law School, 1972. I would like to thank Sally Johnson, Peggy Sanner, and Tammy Wyatt-Shaw for valuable suggestions; Cecelia Palmer and Charlotte Wilmerton for processing this piece; and the Harris Trust and the Cowley Endowment for generous, continuing support. Errors that remain are mine.

[1] *See* Judicial Improvements Act of 1990, Pub. L. No. 101-650, 104 Stat. 5089 (codified at 28 U.S.C. §§ 471–482 (Supp. 1989–1990)).

[2] Apologies to Professor John Hart Ely. *See* John Hart Ely, *Suppose Congress Wanted a War Powers Act that Worked*, 88 COLUM. L. REV. 1379, 1379 (1988).

promising, have also had less advisable features. The Essay concludes with suggestions that Congress should adopt to ameliorate these problems.[3]

I. THE CIVIL JUSTICE REFORM ACT

Congress passed the CJRA in response to claims of abuse in the civil litigation process, growing costs and delays associated with civil lawsuits, and decreasing access to the federal civil justice system.[4] For more than a decade and a half, many federal judges had expressed concern about a litigation explosion and increasing litigation abuse.[5] Enactment of the CJRA in 1990 marked a watershed because Congress had previously rejected "most of the judiciary's requests for substantial procedural reform in part out of apparent concern that the courts were applying procedure to undermine substantive statutes."[6]

The Act requires that all ninety-four federal district courts develop a civil justice expense and delay reduction plan by December, 1993.[7] The purpose of the plans is to facilitate the adjudication of civil lawsuits "on the merits, monitor discovery, improve litigation management, and ensure just, speedy, and inexpensive resolutions of civil disputes."[8] The courts are to promulgate the plans after receiving reports and recommendations that advisory groups prepare.[9]

These advisory groups, which the districts appointed ninety days after the statute's passage, were to be "balanced," includ-

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[3] Although this Essay primarily addresses Congress, much of it applies to other individuals and institutions responsible for civil justice reform, such as federal district judges and the Judicial Conference of the United States.

[4] *See* SENATE COMM. ON THE JUDICIARY, JUDICIAL IMPROVEMENTS ACT OF 1990, S. REP. No. 416, 101st Cong., 2d Sess. 103 (1990), *reprinted in* 1990 U.S.C.C.A.N. 6802, 6804–05; Jeffrey J. Peck, *"Users United": The Civil Justice Reform Act of 1990*, LAW & CONTEMP. PROBS., Summer 1991, at 105, 105–09.

[5] *See, e.g.*, Order Amending the Federal Rules of Civil Procedure, 446 U.S. 997, 1000 (1980) (Powell, J., dissenting); National Hockey League v. Metropolitan Hockey Club, 427 U.S. 639, 640–41, 643 (1976); Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 740–41 (1975).

[6] Carl Tobias, *Civil Justice Reform and the Balkanization of Federal Civil Procedure*, 24 ARIZ. ST. L.J. (forthcoming Feb. 1993) (manuscript at 14 n.55, on file with author) [hereinafter Tobias, *Balkanization*]. *See generally* Carl Tobias, *Judicial Discretion and the 1983 Amendments to the Federal Civil Rules*, 43 RUTGERS L. REV. 933, 961–63 (1991) [hereinafter Tobias, *Discretion*] (suggesting that courts were applying procedure to erode substance of statutes).

[7] *See* 28 U.S.C. § 471 (Supp. 1989–1990).

[8] *Id.* § 471.

[9] *See id.* § 472.

ing lawyers as well as persons representative of litigants who appear in the courts.[10] Each advisory group must thoroughly evaluate the condition of the district's criminal and civil dockets, "identify trends in case filings and in the demands being placed on the court's resources," and designate the "principal causes of cost and delay in civil litigation" that the district experiences.[11] The advisory groups, in formulating suggestions, must consider the particular needs and circumstances of the court, its parties, and their attorneys while ensuring that each contributes significantly to "reducing cost and delay and thereby facilitating access to the courts."[12]

The courts, upon receiving the groups' reports and recommendations, must consider the documents and confer with the groups and then must consider and may adopt the eleven principles, guidelines, and techniques (primarily governing case management, discovery, and alternative dispute resolution) enumerated in the statute or any other measures which could decrease expense and delay.[13] Thirty-four districts issued civil justice plans before December 31, 1991, to qualify for designation as EIDCs.[14] The Judicial Conference Committee on Court Administration and Case Management officially designated those courts as EIDCs on July 30, 1992.[15] The next section of this Essay evaluates nascent civil justice planning in these districts.

II. Early Implementation of the CJRA

A. *The Implementation Process*

Nearly all of the thirty-four EIDCs, relying on the work of, and in consultation with, their advisory groups, seem to have

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[10] *See id.* § 478(b).
[11] *Id.* § 472(c)(1).
[12] *Id.* § 472(c)(2)–(3).
[13] *See id.* §§ 472(a), 473(a)–(b).
[14] *See* Carl Tobias, *Judicial Oversight of Civil Justice Reform*, 140 F.R.D. 49, 56 (1992) (listing EIDCs).
[15] *See, e.g.*, Letter from Robert M. Parker, Chair, Judicial Conference of the United States Committee on Court Administration and Case Management, to Gene E. Brooks, Chief Judge, United States District Court for the Southern District of Indiana (July 30, 1992) (on file with the *Harvard Journal on Legislation*); Letter from Robert M. Parker, Chair, Judicial Conference of the United States Committee on Court Administration and Case Management to Paul G. Hatfield, Chief Judge, United States District Court for the District of Montana (July 30, 1992) (on file with the *Harvard Journal on Legislation*).

undertaken the type of introspection and prescribed the kind of procedures that Congress envisioned. Practically every court carefully followed the guidance in the CJRA[16] and was attentive to the statutory goals of reducing expense and delay in civil litigation.

The courts surveyed their civil and criminal dockets and apparently premised procedural provisions only on supporting data.[17] These districts considered and adopted, as indicated, the statutorily-enumerated principles, guidelines, and techniques, especially those covering case management, discovery, and alternative dispute resolution ("ADR").[18] Some courts closely consulted with their advisory groups or conferred with other districts. For instance, the Advisory Group for the Eastern District of Pennsylvania was one of the first groups to issue its report and recommendations, and those received broad distribution, apparently serving as models for other groups and districts.[19] Additional courts clearly responded to the recommen-

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[16] *See, e.g.*, United States District Court for the Southern District of Indiana, Civil Justice Expense and Delay Reduction Plan (Dec. 31, 1991) [hereinafter Southern District of Indiana Plan] (on file with the *Harvard Journal on Legislation*); United States District Court for the District of Massachusetts, Expense and Delay Reduction Plan (Nov. 18, 1991) [hereinafter Massachusetts Plan] (on file with the *Harvard Journal on Legislation*). I emphasize the plans, rather than the advisory groups' reports and recommendations on which the districts based the plans, because the plans impose procedures that affect judges, lawyers, and litigants and because the districts are not required to adopt advisory group suggestions. Moreover, nearly every advisory group seems to have followed the guidance which Congress provided in § 472 of the Act. For example, the groups promptly completed comprehensive assessments of the courts' criminal and civil dockets as § 472(c)(1) requires. *See, e.g.*, Report of the Advisory Group, United States District Court for the District of Montana 14–32 (Aug. 1991) [hereinafter Montana Report] (on file with the *Harvard Journal on Legislation*); Report of the Advisory Group of the United States District Court for the Eastern District of Pennsylvania 8–30 (Aug. 1, 1991), *reprinted in* 138 F.R.D. 167, 190–212 (1991) [hereinafter Eastern District of Pennsylvania Report]. The groups also appear to have followed the suggestions in § 472(c)(1) by identifying trends in case filings and demands imposed on the courts' resources, designating the primary causes of expense and delay in civil cases, and examining how those could be reduced with better evaluation of the impact of new legislation on courts. *See, e.g.*, Report and Proposed Plan of the Advisory Group, United States District Court for the Eastern District of Wisconsin 2–20 (Dec. 1991) (on file with the *Harvard Journal on Legislation*); Final Report from the Advisory Group to the United States District Court for the District of Delaware 11–49 (Oct. 1, 1991) (on file with the *Harvard Journal on Legislation*).

[17] *See, e.g.*, United States District Court for the District of Kansas, Civil Justice Reform Act Expense and Delay Reduction Plan 1–4 (Dec. 31, 1991) (on file with the *Harvard Journal on Legislation*); Massachusetts Plan, *supra* note 16, at 4–13.

[18] *See, e.g.*, Southern District of Indiana Plan, *supra* note 16, at 3–15; United States District Court for the District of Wyoming, Civil Justice Expense and Delay Reduction Plan 11–17 (Dec. 31, 1991).

[19] *See* Eastern District of Pennsylvania Report, *supra* note 16; Telephone Interview with Lauren K. Robel, Professor of Law, University of Indiana, Bloomington, and Advisory Group Reporter, Southern District of Indiana (Sept. 21, 1992) (noting the

dations that their advisory groups forwarded, articulating the districts' reasons for accepting or rejecting the suggestions.[20]

A smaller number of courts carefully treated numerous issues of authority that civil justice reform raises. For example, several districts rejected certain of their advisory groups' recommendations, finding that the courts lacked the requisite authority to implement the suggestions, while others refused to prescribe procedures that would conflict with the Federal Rules of Civil Procedure or that they had no clear authority to adopt.[21] Some courts similarly eschewed reliance on procedures that the Advisory Committee on the Civil Rules proposed as part of a comprehensive package of Federal Rules amendments which could not become effective until December, 1993, at the earliest.[22]

Numerous districts seemed sensitive to related questions of implementation. Most courts expressly provided that new procedures adopted in their civil justice plans would only become effective through the regular process for promulgating new, or amending presently applicable, local rules.[23] A number of dis-

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broad distribution of the Eastern District of Pennsylvania report and recommendations and its role as a model).

[20] *See, e.g.*, United States District Court for the Western District of Wisconsin, Civil Justice Expense and Delay Reduction Plan app. 2 (Dec. 31, 1991) [hereinafter Western District of Wisconsin Plan] (on file with the *Harvard Journal on Legislation*); United States District Court for the Southern District of Illinois, Civil Justice Delay and Expense Reduction Plan 14–17, 19–21 (Dec. 27, 1991) [hereinafter Southern District of Illinois Plan].

[21] *E.g.*, Western District of Wisconsin Plan, *supra* note 20, app. 2, at 2, 6; *see also* United States District Court for the Northern District of Georgia, Civil Justice Expense and Delay Reduction Plan 18 (Dec. 17, 1991) (questioning whether specific authority is needed to institute mandatory non-binding court-annexed arbitration) (on file with the *Harvard Journal on Legislation*); United States District Court of the Southern District of Florida, Civil Justice Expense and Delay Reduction Plan 95 (Nov. 1991) (recognizing that court lacked "power to redress the primary factors which cause unreasonable cost and delay in" district) (on file with the *Harvard Journal on Legislation*).

[22] *See, e.g.*, Western District of Wisconsin Plan, *supra* note 20, app. 2, at 2; *cf.* United States District Court for the District of Alaska, Civil Justice Expense and Delay Reduction Plan 4 (Dec. 16, 1991) (favoring some form of automatic, mandatory prediscovery disclosure and expecting to experiment with mandatory disclosure, but considering counterproductive an attempt to predict changes involving discovery in Federal Rules or in local rules) (on file with the *Harvard Journal on Legislation*). For the comprehensive package of Federal Rules amendments, see Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Preliminary Draft of Proposed Amendments of Federal Rule of Civil Procedure and the Federal Rules of Evidence, 137 F.R.D. 53 (1991) [hereinafter Proposed Amendments 1991]. *See also* Randall Samborn, *U.S. Civil Procedure Revisited*, NAT'L L.J., May 4, 1992, at 1, 12 (describing package proposed at April, 1992 meeting of the Advisory Committee on the Civil Rules).

[23] *See, e.g.*, United States District Court for the Southern District of West Virginia, Civil Justice Expense and Delay Reduction Plan 74 (Dec. 30, 1991) (on file with the

tricts apparently attempted to keep their local rules committees apprised of, and involved during, the entire planning process, and quite a few courts appointed members of these committees to their advisory groups. Indeed, the local rules committee for the Southern District of Indiana simply served as the advisory group.[24] Other courts instituted measures to guarantee, insofar as possible, that federal court practitioners would have notice that new procedural provisions were effective.[25]

B. *Specific Reforms Implemented*

One primary goal of the CJRA is to reduce expense and delay in the civil justice system.[26] Several districts, accordingly, adopted procedures that were expressly intended to address these goals, such as placing numerical limitations on interrogatories, depositions, and the length of briefs.[27] Moreover, the Eastern District of Texas, one of the few courts which attempted to attack directly the growing expense in civil litigation,[28] imposed a "maximum fee schedule for contingency fee cases . . .

Harvard Journal on Legislation); Civil Justice Expense and Delay Reduction Plan for Implementation of the Civil Justice Reform Act of 1990 in the District of New Jersey 17–25 (Dec. 19, 1991) (on file with the *Harvard Journal on Legislation*).

[24] *See* Southern District of Indiana, Report of the Civil Justice Reform Advisory Group i (Dec. 1991) (on file with the *Harvard Journal on Legislation*); Lauren K. Robel, Remarks at the Roundtable on Civil Justice Reform, Law & Society Ass'n Annual Meeting (May 30, 1992).

[25] *See, e.g.*, Southern District of West Virginia, Plan for Implementation of the Civil Justice Expense and Delay Reduction Plan 72–73 (Dec. 30, 1991) (on file with the *Harvard Journal on Legislation*); *Notice: Proposed Amendments to the Rules of Procedure of the U.S. District Court for Montana*, MONT. LAW., Feb. 1992, at 13; *see also* United States District Court for the District of Montana, Civil Justice Expense and Delay Reduction Plan 26–38 (Dec. 1991) [hereinafter Montana Plan] (providing proposed rule amendments) (on file with the *Harvard Journal on Legislation*). Of course, notice to members of the bar within the district may not reach non-members who practice in the district.

[26] *See supra* notes 4, 8 and accompanying text.

[27] *See, e.g.*, Southern District of Illinois Plan, *supra* note 20, at 18 (setting a 20-page limit on the length of briefs); United States District Court for the Eastern District of New York, Civil Justice Expense and Delay Reduction Plan 7 (Dec. 17, 1991) (limiting the number of interrogatories and depositions) (on file with the *Harvard Journal on Legislation*).

[28] *See* United States District Court for the Eastern District of Texas, Civil Justice Expense and Delay Reduction Plan (Dec. 20, 1991) [hereinafter Eastern District of Texas Plan] (on file with the *Harvard Journal on Legislation*). A major purpose for passage of the CJRA was to reduce expense. *See supra* note 8 and accompanying text. Moreover, the Act specifically instructs advisory groups to insure that the court, litigants, and their counsel contribute significantly to reducing expense. 28 U.S.C. § 472(c)(3); *see also supra* note 12 and accompanying text.

of 33% of the total award or settlement," which the court can modify in exceptional circumstances.[29]

Other districts have adopted less direct, but creative, approaches to limiting cost and delay. The Montana District, for instance, is employing peer review committees comprised of federal court practitioners who will review possible discovery and litigation abuse at the instigation of judicial officers to determine whether abuse has occurred.[30] The committees could reduce the prevalence of discovery disputes and abusive litigation practices, thereby saving resources of judges, lawyers, and litigants.[31]

Some districts are also implementing innovative approaches to alternative dispute resolution, which could decrease cost and delay. For example, the Western District of Missouri is randomly assigning one-third of its civil caseload automatically to a compulsory non-binding ADR program.[32] A few courts, including the Idaho District and the Northern District of West Virginia, are instituting "settlement weeks" in which volunteer attorneys trained as mediators or neutrals attempt to settle civil cases.[33]

The advisory group for the Eastern District of California, in response to concerns expressed by local attorneys,[34] is experi-

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[29] Eastern District of Texas Plan, *supra* note 28, at 7–8. "In cases where statutory attorneys' fees are recoverable, such as civil rights cases, the court shall approve a reasonable fee." *Id.* at 8.

[30] *See* Montana Plan, *supra* note 25, at 17; Carl Tobias, *Federal Court Procedural Reform in Montana*, 52 MONT. L. REV. 433, 449 (1991).

[31] The judges and some lawyers in the Montana District apparently hold these views. I am less sanguine and believe that use of the committees may raise due process concerns. *See* Carl Tobias, *The Montana Federal Civil Justice Plan*, 53 MONT. L. REV. 91, 97–98 (1992).

[32] *See* United States District Court for the Western District of Missouri, Early Assessment Program Early Implementation Project 1 (Oct. 31, 1991) [hereinafter Western District of Missouri Early Implementation Project] (on file with the *Harvard Journal on Legislation*). Jerome T. Wolf, chair of the advisory group, claims that the cost of delay makes the experiment "worth it whether it proves out or not." Randall Samborn, *The Battle Escalates on Reform*, NAT'L L.J., Mar. 2, 1992, at 1, 29. *See generally* Kim Dayton, *The Myth of Alternative Dispute Resolution in the Federal Courts*, 76 IOWA L. REV. 889, 947–57 (1991) (discussing judicial authority to require participation in ADR); Tobias, *supra* note 14, at 49.

[33] *See* United States District and Bankruptcy Court for the District of Idaho, Expense and Delay Reduction Plan 12–13 (Dec. 1, 1991) [hereinafter Idaho Plan] (on file with the *Harvard Journal on Legislation*); Report of the Advisory Group to the United States District Court for the Northern District of West Virginia 46–47 (Dec. 1991) (discussing use of "settlement weeks" since 1987) (on file with the *Harvard Journal on Legislation*). I believe that some of the procedures discussed above are problematic as a matter of authority or policy. *Compare supra* note 28 and accompanying text *with infra* note 47 and accompanying text. *See generally* Tobias, *supra* note 14.

[34] *See* Report of the Civil Justice Reform Act Advisory Group of the United States

menting with pre-argument notification to counsel by the court of the issues to be argued during hearings and with time-tailored scheduling of motions.[35] The district thereby hopes to reduce the amount of time lawyers spend waiting in the courthouse to argue motions.

In addition to the various reforms introduced to reduce expense and delay, early civil justice planning seems to have afforded numerous salutary, and perhaps unanticipated, side effects.[36] The Act instituted an unprecedented nationwide experiment which is the first detailed national examination of how all ninety-four federal trial courts function. The advisory groups and the districts have collected, analyzed, and synthesized a wealth of invaluable data on the courts' day-to-day operations. Furthermore, civil justice planning has fostered healthy dialogue between the bench and bar and the advisory groups in specific districts as well as among advisory groups and judges in the ninety-four districts. Planning correspondingly appears to have promoted beneficial interaction, especially involving techniques for expeditiously resolving cases, among the judges in particular districts. It even seems to have led judicial officers in a number of districts to consider how the district qua district might improve civil case disposition.[37]

In short, almost every advisory group and federal district faithfully followed congressional guidance in the CJRA. They closely followed statutory instructions, and they exchanged instructive ideas on the Act's implementation and specific procedures with each other and with additional groups and districts.

District Court for the Eastern District of California 81, 95, 97 (Nov. 21, 1991) (on file with the *Harvard Journal on Legislation*).

[35] *See* United States District Court for the Eastern District of California, Civil Justice Expense and Delay Reduction Plan 5–6 (Dec. 31, 1991) (on file with the *Harvard Journal on Legislation*). The Advisory Group's Reporter believes that this example illustrates the value of a local district's undertaking self-examination. John B. Oakley, Remarks at Roundtable on Civil Justice Reform, Law & Society Ass'n Annual Meeting (May 30, 1992).

[36] The observations in this paragraph are premised on conversations with numerous participants in civil justice reform efforts. *See generally* Don J. DeBenedictis, *An Experiment in Reform*, 78 A.B.A. J., Aug. 1992, at 16 (discussing salutary side effects). Of course, once comprehensive data on civil justice reform are systematically gathered, assessed, and synthesized, many additional insights will be clear.

[37] I am indebted to Donna Stienstra, Research Division, Federal Judicial Center, and John Oakley, Advisory Group Reporter, Eastern District of California, for this idea. Professor Oakley believes that the calendaring approach in the federal system, whereby individual judges manage cases from filing to disposition, may have artificially isolated judges. John Oakley, *supra* note 35. *See generally* Robert F. Peckham, *The Federal Judge as a Case Manager: The New Role in Guiding a Case from Filing to Disposition*, 69 CAL. L. REV. 770 (1981) (discussing judicial case management).

Moreover, the courts adopted numerous procedures that will help achieve the statute's goals of reducing expense and delay, while the EIDCs thus far seem to be relatively efficacious laboratories of experimentation.[38]

C. *Problems in Implementation*

Although many of the above proposals may prove beneficial, several problems have arisen with nascent implementation. Some entities involved in civil justice reform have communicated less effectively than they might have. Most districts neglected to establish necessary baselines for measuring the success of the reform proposals. Moreover, numerous districts apparently did not recognize, or ignored, important problems concerning their authority to implement the various reforms. Furthermore, because each district was assigned the task of suggesting reforms tailored to its own particular needs, the proposals developed have led to considerable interdistrict disuniformity.

1. Communications Between Courts and Advisory Groups

Some courts seem to have relied minimally on the work of, or consulted little with, their advisory groups. For example, there apparently was rather limited interaction between the judges and the advisory group in the Montana District, and virtually no interchange between the federal judges or the advisory group and the local rules committee. Indeed, the judges ultimately assumed complete responsibility for drafting the proposed changes in local rules that accompanied the civil justice plan.[39] Moreover, the permanent law clerk for the Chief Judge served as the advisory group reporter.[40] A number of other courts employed similar models by relying substantially on in-

[38] Of course, it is too early to ascertain precisely how effective the districts ultimately will be. This must await actual application of the procedures prescribed and their systematic evaluation. *See, e.g.*, 28 U.S.C. § 475. *See generally* A. Leo Levin, *Local Rules as Experiments: A Study in the Division of Power*, 139 U. PA. L. REV. 1567 (1991) (suggesting that experimentation by district courts with inconsistent local rules be allowed, employed, and evaluated).

[39] The observations in this sentence and the one above are based on conversations with several individuals involved in civil justice planning in Montana and several members of the local rules committee. *See also* Montana Plan, *supra* note 25, at 26–38.

[40] *See* Montana Report, *supra* note 16.

ternal court personnel.[41] Such an approach may have restricted the exchange between the bench and the bar that Congress in the CJRA intended and perhaps compromised the independence of some groups.

2. Establishing Baselines

Another significant problem with early civil justice planning is that only a minuscule number of districts seem to have created appropriate baselines relating to expense and delay against which to measure progress. A comparatively crude example of baselines is the provision in one district for randomly sending one-third of its civil cases to a mandatory non-binding ADR program. Any expense or delay reduction in those cases could then be compared with cost and delay in cases not so assigned.[42]

Without specific baselines, it is exceedingly difficult to ascertain accurately what civil justice planning has achieved. The lack of appropriate baselines will also make it difficult for the districts to discharge their statutory responsibilities for assessing "annually the condition of the court's civil and criminal dockets with a view of determining appropriate additional actions that may be taken by the court to reduce cost and delay in civil litigation and to improve the litigation management practices of the court."[43] Moreover, virtually no districts seem to have solved the exceedingly difficult problem of establishing expense baselines that would answer such problematic questions as the meaning of costs and who would bear those costs.

3. Authority to Implement Reforms

One of the most difficult and important issues involved in civil justice reform is judicial authority to implement procedures

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[41] *See, e.g.*, Report of the Western District of Wisconsin Advisory Group, title page (Nov. 15, 1991) (on file with the *Harvard Journal on Legislation*); District of Wyoming Advisory Group, Report and Recommended Plan (Nov. 1991) (on file with the *Harvard Journal on Legislation*). The other major model was to employ a law professor as advisory group reporter. *See, e.g.*, United States District Court for the Northern District of Indiana, Report of the Advisory Group on the Reduction of Cost and Delay in Civil Cases (Oct. 1991) (on file with the *Harvard Journal on Legislation*); Advisory Group for the Eastern District of Virginia, Report of the Civil Justice Reform Act, title page (Sept. 19, 1991) (on file with the *Harvard Journal on Legislation*).

[42] *See* Western District of Missouri Early Implementation Project, *supra* note 32, at 1–14. It is relatively easy to establish baselines based on the procedures that existed in districts at the time civil justice reform commenced.

[43] *See* 28 U.S.C. § 475.

which are meant to reduce expense or delay. Some districts have claimed that they possess very broad authority under the CJRA to prescribe procedures which deviate from the Federal Rules and the United States Code. A few have even asserted that the CJRA provides them carte blanche to adopt any procedures which will reduce cost or delay, regardless of whether they contravene federal requirements. Indeed, the plan for the Eastern District of Texas expressly states that "to the extent that the Federal Rules of Civil Procedure are inconsistent with this Plan, the Plan has precedence and is controlling."[44] That district promulgated an offer of judgment provision which conflicts with both the time limitations of Federal Rule 68 and the Rule's requirements governing discrepancies between offers made and judgments ultimately secured.[45] The court's civil justice plan also imposed limits on contingency fees[46] which may interfere with congressional prerogatives to allocate litigation costs.[47]

Other courts have prescribed procedures that seem inconsistent with the Federal Rules or the United States Code, although these districts have been less explicit than the Eastern District of Texas. Perhaps the most troubling example has been the provision for mandatory pre-discovery disclosure. Twenty EIDCs have adopted varying disclosure requirements that resemble suggestions to amend the Federal Rules which the Civil Rules Committee proposed in 1991.[48] Those recommendations, which were vociferously attacked by nearly all segments of the bar,[49] would dramatically change traditional ideas of, and present rules governing, discovery.[50] The Committee substantially reversed its position twice last spring and eventually prescribed proposals similar to the ones initially recommended.[51] Lawyers

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[44] Eastern District of Texas Plan, *supra* note 28, at 9.

[45] *See* Tobias, *Balkanization*, *supra* note 6 (manuscript at 31). *Compare* Eastern District of Texas Plan, *supra* note 28, at 10 *with* FED. R. CIV. P. 68.

[46] Eastern District of Texas Plan, *supra* note 28, at 7–8.

[47] *See* Kaiser Aluminum & Chem. Corp. v. Bonjourno, 494 U.S. 827, 835 (1990) (explaining congressional prerogatives to allocate costs).

[48] *See, e.g.*, United States District Court for the District of Delaware, Civil Justice Expense and Delay Reduction Plan 2–3 (Dec. 23, 1991) (on file with the *Harvard Journal on Legislation*); Report and Plan of the Advisory Group of the District Court of the Virgin Islands 36–37 (Dec. 23, 1991) (on file with the *Harvard Journal on Legislation*); *see also* WINTHROP, STIMSON, PUTNAM & ROBERTS, NATIONAL OVERVIEW OF PLAN PROVISIONS FOR AUTOMATIC DISCLOSURE 1 (1992).

[49] *See* Samborn, *supra* note 22, at 1, 12.

[50] *See* Proposed Amendments 1991, *supra* note 22, 137 F.R.D. at 83–84, 87–88.

[51] *See* Samborn, *supra* note 22, at 1.

across the country are already invoking the discovery disclosure provisions promulgated under the CJRA, frequently for tactical advantage.[52]

Another illustration of procedures for which courts may lack sufficient authority is the Montana district's prescription for assigning civil lawsuits co-equally to Article III judges and magistrate judges.[53] The court will notify parties whose cases are assigned to magistrate judges that they may ask for reassignment, but that right is deemed waived if the requests are not filed in a timely fashion.[54] The authority for co-equal assignment is unclear, and the provision may contravene procedures for securing consent to magistrate jurisdiction in 28 U.S.C. § 636(c).[55]

The statutory language and the legislative history of the CJRA show that Congress intended for courts to have considerably narrower authority to adopt inconsistent provisions than some of the districts have asserted.[56] Indeed, the Rules Enabling Act provides that local rules are to be "consistent with Acts of Congress" and the Federal Rules of Civil Procedure.[57] Moreover, the current version of Rule 83 states that, "in all cases not provided for by rule, the district judges and magistrates may

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[52] This observation is based on conversations with numerous attorneys who practice in the federal courts.

[53] *See* Montana Plan, *supra* note 25, at 3–4; *cf.* United States District Court for the Eastern District of Arkansas, Civil Justice Expense and Delay Reduction Plan 3 (Dec. 30, 1991) (randomly assigning civil cases on experimental basis to district judges and magistrate judges) (on file with the *Harvard Journal on Legislation*); United States District Court for the District of Oregon, Civil Justice Expense and Delay Reduction Plan 20 (Dec. 30, 1991) [hereinafter Oregon Plan] (explaining that the objective of case assignment procedures is to incorporate all full-time magistrate judges into a "civil case assignment system on a co-equal basis with the district judges") (on file with the *Harvard Journal on Legislation*); *see also* Tobias, *supra* note 31, at 93 n.9 (discussing co-equal assignment of cases).

[54] *See* Montana Plan, *supra* note 25, at 4.

[55] *See* 28 U.S.C. § 636(c); Columbia Record Prods. v. Hot Wax Records, 966 F.2d 515 (9th Cir. 1992) (citing applicable case law); *In re* San Vincente Medical Partners, 865 F.2d 1128 (9th Cir. 1989) (same); Judicial Conference of the United States, Civil Justice Reform Act Report, Development and Implementation of Plans by Early Implementation Districts and Pilot Courts 5 (June 1, 1992) [hereinafter Judicial Conference Report] (Ninth Circuit Review Committee questioning validity of Montana provision for co-equal assignment); Tobias, *supra* note 31, at 93 n.9 (discussing judicial authority to so assign cases).

[56] *See* SENATE COMM. ON THE JUDICIARY, *supra* note 4, at 3–31, *reprinted in* 1990 U.S.C.C.A.N. at 6805–35 (legislative history including no indication that Congress intended to grant broad authority); Lauren K. Robel, Fractured Procedure (1992) (painstakingly analyzing legislative history and showing that Congress intended narrow ambit of authority) (unpublished manuscript on file with author).

[57] 28 U.S.C. § 2071(a) (1988). *See generally* Tobias, *Balkanization*, *supra* note 6 (manuscript at 30) (discussing Rules Enabling Act requirements).

regulate their practice in any manner not inconsistent with" the Federal Rules.[58] Therefore, a number of districts have apparently exceeded their authority.

This exercise of authority and the inconsistencies thus created can have detrimental ramifications. Most significantly, procedures adopted under the CJRA can lead to conflicts between local and federal procedural provisions, thereby implicating delicate interbranch relationships of Congress and the federal judiciary. For example, when districts adopt local procedures that contradict federal requirements, this can enhance the judiciary's power at the expense of Congress and litigants, such as civil rights plaintiffs, whose vindication of substantive rights Congress intended federal courts to facilitate.[59] More specifically, if local procedures contravene procedural provisions in substantive statutes affording employment discrimination plaintiffs certain tactical advantages[60] or make rigid what are now flexible requirements in the Federal Rules, such as several discovery rules,[61] those conflicts can erode congressional power and disadvantage parties whom Congress intended to benefit.[62]

4. Disuniformity Among Districts

Another significant problem has been each EIDCs promulgation of procedures that conflict with ones that other districts

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[58] FED. R. CIV. P. 83. The 1991 proposal to amend Rule 83 would have permitted experimentation employing inconsistent local rules for periods of less than five years with Judicial Conference approval. *See* Proposed Amendments 1991, *supra* note 22, 137 F.R.D. at 152–55. The Standing Committee, however, recently withdrew that proposal in apparent deference to the CJRA efforts. *See* Committee on Rules of Practice and Procedure of the Judicial Conference of the United States, Proposed Amendments of Federal Rules of Civil Procedure (July 1992).

[59] *See* Tobias, *Discretion*, *supra* note 6, at 961–63; *cf.* Carl Tobias, *Public Law Litigation and the Federal Rules of Civil Procedure*, 74 CORNELL L. REV. 270 (1989) (discussing how narrow judicial application of procedure can enhance the judiciary's power). An important reason for this is that Congress does not have the opportunity to modify local procedural changes in the same way that it may alter proposed Federal Rules amendments. *See* 28 U.S.C. § 2074. *See generally* Tobias, *Balkanization*, *supra* note 6 (manuscript at 25) (discussing how local procedural changes bypass Congress).

[60] *See* Phyllis Tropper Baumann et al., *Substance in the Shadow of Procedure: The Integration of Substantive and Procedural Law in Title VII Cases*, 33 B.C. L. REV. 211 (1992). Narrow judicial interpretation of such statutes in part prompted passage of the Civil Rights Act of 1991. *See* Pub. L. No. 102-166, 105 Stat. 1071 (1991). *See generally* Carl Tobias, *Civil Rights Procedural Problems*, 70 WASH. U. L.Q. 801 (1992) (discussing the Civil Rights Act of 1991).

[61] *See, e.g.*, FED. R. CIV. P. 26(a)–(b); *cf.* Tobias, *supra* note 59, at 296–301 (giving example of judicial imposition of heightened pleading requirements under Rule 8).

[62] *See* Tobias, *Balkanization*, *supra* note 6.

prescribed.[63] Congress structured the CJRA in ways that inexorably foster some interdistrict disuniformity because each district must take into account and may adopt the eleven principles, guidelines, and techniques listed in the statute and any other procedures which could decrease expense or delay.[64] The highly inconsistent procedures that the EIDCs have promulgated complicate the efforts of attorneys and parties, such as the Department of Justice, the Sierra Club, and General Motors, who litigate in multiple districts. All parties and lawyers, but particularly those with limited resources such as public interest litigants, have difficulty finding, mastering, and conforming to local procedures that differ substantially from district to district.[65]

III. SUGGESTIONS

When passing the CJRA, Congress pursued the laudable goals of reducing expense and delay in civil litigation through nationwide procedural experimentation. Civil justice planning has already produced an enormous quantity of illuminating data which enhances understanding of how the federal courts discharge their responsibilities. Congress apparently attempted, however, to accomplish more than could be efficaciously achieved at one time by employing too many instrumentalities and procedures. Congress may have so drafted the legislation that its implementation could undermine the Act's expressly stated purpose to reduce cost and delay.[66]

A general illustration of this statutory complication is the Act's placement of primary responsibility for implementation of the various reforms in all ninety-four federal districts, many of whose advisory groups and judges were effectively working at once.[67] Because the EIDCs labored simultaneously, few courts

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[63] For additional discussion, see *id.*

[64] *See* 28 U.S.C. § 473(a)–(b). Congress apparently attempted to maintain some uniformity by providing that all districts must consider and may adopt the eleven listed procedures.

[65] *See* Tobias, *Balkanization*, *supra* note 6 (manuscript at 38–39). *See generally* Carl Tobias, *Rule 11 and Civil Rights Litigation*, 37 BUFF. L. REV. 485 (1988–1989) (discussing difficulties that resource-deficient litigants confront).

[66] *See* 28 U.S.C. §§ 471, 472(c)(3); *supra* notes 4, 8, 12 and accompanying text.

[67] The districts had to appoint all of the advisory groups by the same date, ninety days after the Act's passage. 28 U.S.C. § 478(a). The 34 districts seeking EIDC status had to issue plans by December 31, 1991. Judicial Improvements Act of 1990 § 103(c). Some of the remaining sixty districts issued plans before the end of 1992. *See, e.g.*, Letter from Barefoot Sanders, Chief Judge, United States District Court for the North-

were able to benefit from the experimentation of other districts or to evaluate the efficacy of the reforms. Moreover, the statute instructs the courts that they must consider and could promulgate varying combinations of eleven principles, guidelines, and techniques and any additional procedures which promise to decrease expense or delay. Indeed, the thirty-four EIDCs have already adopted their plans and the remaining districts must issue plans by the statutory deadline of December, 1993.[68]

These difficulties have fostered considerable confusion among the advisory groups and the federal districts. For instance, the problems led the Advisory Group for the Eastern District of New York to request that the Standing Committee observe a "three-year moratorium on affected national rules so that each district can have a fair opportunity to assess reforms at the local level implemented through" the CJRA.[69] The difficulties have also complicated the efforts of lawyers and litigants to understand and comply with the disparate procedures applicable in various districts[70] and could frustrate the efforts of certain entities, such as government agencies and public interest groups, to monitor civil justice planning and changes in federal civil procedure.[71]

Congress must act promptly and decisively to capitalize on the civil justice reform efforts which advisory groups and districts have undertaken. Experimentation with civil justice reform to date has been sufficiently broad and diverse to permit the identification of those procedures which have the greatest promise. More expansive experimentation may yield minimal additional benefit and could even be counterproductive. Congress should evaluate the existing reform efforts and institute measures that will maximize the beneficial, and minimize the detrimental, features of nascent civil justice planning. Congress should recognize that certain elements of the CJRA, although

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ern District of Texas, to Carl Tobias (June 5, 1992) (indicating plan would issue in 1992) (on file with the *Harvard Journal on Legislation*); *cf.* Civil Justice Expense and Delay Reduction Plan for the United States District Court for the Western District of Missouri (Apr. 30, 1992) (recently issued plan) (on file with the *Harvard Journal on Legislation*).

[68] Judicial Improvements Act of 1990 § 103(b).

[69] Letter from Edwin J. Wesely, Chair, Advisory Group for the Eastern District of New York, to Robert Keeton, Chair, Committee on Rules of Practice and Procedure of the Judicial Conference of the United States 3 (Feb. 13, 1992) (on file with the *Harvard Journal on Legislation*).

[70] *See supra* notes 59–62, 64–65 and accompanying text.

[71] *See* Tobias, *Balkanization*, *supra* note 6 (manuscript at 12 n.50).

well-intentioned, may have posed very real practical problems of implementation.

An efficacious approach would be some form of mid-course correction that circumscribes the CJRA's open-ended character. For example, Congress might draw on EIDC experimentation to designate a reduced number of procedures with the greatest potential for decreasing expense or delay, such as the setting and enforcement of firm trial dates[72] or certain types of voluntary ADR,[73] and prescribe experimentation with them in relatively few districts. Congress should at least limit one of the primary parameters: the number of procedures which courts can adopt or the number of districts which participate in civil justice reform.

Regardless of how Congress chooses to restrict civil justice planning, it must ensure that evaluators assemble, assess, and synthesize information about the procedures' efficacy for enough time to ascertain which ones are preferable.[74] For instance, Congress might consider the twenty EIDCs that are currently implementing the highly controversial compulsory prediscovery disclosure proposals an adequate number to afford a sense of the concept's efficacy. Once these courts have experimented with the technique and observers have systematically evaluated the procedure, the federal judiciary and Congress can decide if it is practicable and, if so, how widespread its use should be. Congress correspondingly ought to discourage the remaining districts from employing such discovery, pending analysis of its implementation in the EIDCs. This course of action should ultimately enable Congress to identify the most promising procedures, so that courts might apply them in a greater number of districts or even nationally, as indicated.[75]

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[72] *See, e.g.*, Oregon Plan, *supra* note 53, at 4 (stating that firm trial dates are essential to effective case management system); Idaho Plan, *supra* note 33, at 3 (same); Montana Plan, *supra* note 25, at 14 (same).

[73] *See supra* notes 32–33 and accompanying text.

[74] I recognize that Congress has specifically prescribed numerous studies. Each district must prepare an annual assessment. 28 U.S.C. § 475. The Judicial Conference recently completed a report to Congress on the EIDCs. *See* Judicial Conference Report, *supra* note 55. What I have in mind is a study like that which the Rand Corporation is preparing on the pilot courts program for submission in late 1995. *See* Judicial Improvements Act of 1990 § 105(c); *supra* note 43 and accompanying text (noting the difficulty of assessing efficacy without baselines).

[75] I envision Congress and the courts gradually expanding the number of procedures that are employed in a steadily growing number of districts. When a procedure proves to be very effective, system-wide adoption in the Federal Rules probably will be warranted.

Congress can rely on several sources for this broad approach. Experimentation with court-annexed arbitration, which some districts instituted in the late 1970s and which Congress approved during the 1980s and codified in the 1988 Judicial Improvements Act, is one helpful illustration.[76] Because the CJRA expressly provides for the EIDCs, however, they are most directly applicable. These courts comprise thirty-six percent of the ninety-four districts. Moreover, the EIDCs are sufficiently diverse and representative in terms, for example, of geography, local legal culture, and the procedures adopted. The EIDCs have also undertaken enough implementation to serve as effective crucibles for experimentation.

The thirty-four courts which are EIDCs nevertheless may be too numerous for efficacious experimentation and evaluation. If Congress finds that to be true, it could easily select an appropriate subset. For instance, Congress might choose a group, sufficiently small in number, yet large enough to be representative and to provide sufficiently informative insights. Existing subsets are the five demonstration[77] and ten pilot districts[78] that the Act created and the twenty "volunteer" EIDCs that satisfied the CJRA's requirements.[79] Congress might designate certain demonstration districts in terms of specific procedures with which they are experimenting.[80] Congress could base the selection of pilot districts, for example, on their statutorily mandated composition as metropolitan or rural districts.[81] Congress may premise its choice of volunteer districts, for instance, on the criteria suggested for demonstration or pilot districts.

Congress should at least extend the effective date by which the remaining districts that are not EIDCs must adopt plans, thereby enabling evaluators to analyze rigorously the effective-

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[76] *See* 28 U.S.C. §§ 651–658; BARBARA MEIERHOEFER, COURT-ANNEXED ARBITRATION IN TEN DISTRICT COURTS (Federal Judicial Center 1990).

[77] Judicial Improvements Act of 1990 § 104.

[78] *Id.* § 105.

[79] *Id.* § 103(c); *see also supra* note 12 (listing demonstration, pilot, and volunteer EIDCs).

[80] There are only five demonstration districts. Congress instructed two to "experiment with systems of differentiated case management" and three to "experiment with various methods of reducing cost and delay in civil litigation." Judicial Improvements Act of 1990 § 104(b).

[81] "At least five of the Pilot Districts designated by the Judicial Conference shall be judicial districts encompassing metropolitan areas," and the "plans implemented by the Pilot Districts shall include the six principles and guidelines of litigation management and cost and delay reduction" in 28 U.S.C. § 473(a). Judicial Improvements Act of 1990 § 105(b)(1)–(2).

ness of the procedures which the EIDCs are applying. This would permit all districts to make more educated decisions about which procedures are most workable. If Congress does not extend the effective date, the advisory groups that are compiling reports and recommendations and the districts which are developing plans should delay their efforts as much as possible, thus facilitating consideration of the maximum information prior to finalizing their work. The groups and districts should wait as late as practicable in 1993 in order to have the benefit of two annual assessments which most of the EIDCs would have compiled by then.[82]

Finally, Congress should expeditiously clarify whether and, if so, the extent to which, districts can promulgate procedures that conflict with ones which other districts prescribe or with the Federal Rules or provisions of the United States Code. Congress should precisely delineate the breadth of the districts' authority to promulgate inconsistent procedures under the CJRA and must sharply circumscribe the power which the courts have asserted. The complications that these conflicts and expansive assertions of power create simply outweigh the value of broader experimentation. A measured approach which properly balances the needs for procedural certainty and consistency and for effective experimentation is readily available: the recently withdrawn proposal to amend Rule 83 which would have permitted districts to experiment with inconsistent procedures for appropriately limited periods subject to Judicial Conference approval.[83] Congress should concomitantly seek to reduce interdistrict disuniformity by, for example, restricting the number of procedures that districts might adopt or limiting the extent to which courts can rely on the sixth, open-ended technique which permits them to prescribe such other procedures as the districts consider appropriate in reducing cost and delay.[84]

IV. Conclusion

Civil justice reform has been highly controversial. Nonetheless, preliminary civil justice planning in the EIDCs under the

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[82] *See* 28 U.S.C. § 475. The suggestions in the last two sentences are directed more to the advisory groups and the districts than to Congress. The recommendations, however, are relevant to Congress because they are meant to improve implementation.

[83] *See supra* note 58.

[84] 28 U.S.C. § 473(b)(6). Numerous courts apparently have relied on that provision to adopt procedures that are inconsistent or questionable as a matter of authority or policy. *See* Tobias, *Balkanization*, *supra* note 6 (manuscript at 35–37)

Civil Justice Reform Act of 1990 has had considerable promise. If Congress implements the suggestions above, it can maximize the beneficial features of this reform effort. With a streamlined approach to planning, Congress should be able to realize the reform's potential and achieve the statutory goals of reducing expense and delay in federal civil litigation.

NOTE

PRAYER-TREATMENT EXEMPTIONS TO CHILD ABUSE AND NEGLECT STATUTES, MANSLAUGHTER PROSECUTIONS, AND DUE PROCESS OF LAW

ERIC W. TREENE*

In some well-publicized instances, Christian Scientist parents who, in accordance with their religious beliefs, have treated their sick children with prayer rather than modern medicine have found themselves in the midst of criminal prosecutions for manslaughter or child abuse and neglect. Defenses to these prosecutions are often raised in the context of the constitutional right to free exercise of religion. Yet constitutional due process concerns are also involved. Many states have prayer-treatment exemptions to their manslaughter and child abuse and neglect statutes, although the scope of those exemptions is often unclear. As a result, Christian Scientist parents may find themselves accused of violating laws from which they believed they were exempt.

In this Note, Mr. Treene surveys these prayer-treatment exemptions, and analyzes the Christian Scientist cases in light of the due process doctrines of vagueness and reliance. He argues that prosecutions of Christian Scientist parents who, relying on prayer-treatment exemptions, fail to seek medical attention for their sick children, violate the parents' rights to due process of law. He also provides recommendations for statutory change.

On January 13, 1992, the United States Supreme Court drew widespread media attention[1] when it denied certiorari to the State of Minnesota in the case of *State v. McKown*.[2] In *McKown*, the Supreme Court of Minnesota had ruled that the Due Process Clause of the Fourteenth Amendment[3] precluded the prosecution of two Christian Scientist parents for second-degree manslaughter when their son, Ian Ludman, died after they chose to treat him through prayer and spiritual healing rather than with medical care. The court held that since the Minnesota child

* Law Clerk to Hon. John M. Walker, Jr., United States Court of Appeals for the Second Circuit. B.A., 1988, Amherst College; J.D., 1992, Harvard Law School. The author wishes to thank Professor Frank Michelman for his insightful suggestions and broadening guidance.

[1] *See, e.g.*, Kevin Cullen, *Legal Victory for Christian Scientist Pair*, BOSTON GLOBE, Jan. 14, 1992, at 3; *Muhammad Ali, Joe Doherty, Ian Ludman, Jean-Paul Beaubier, Mikhail Gorbachev*, U.S. NEWS & WORLD REP., Jan. 27, 1992, at 21.

[2] 475 N.W.2d 63 (Minn. 1991), *cert. denied*, 112 S. Ct. 882 (1992).

[3] U.S. CONST. amend. XIV.

neglect statute defines medical care to include good faith reliance on spiritual treatment or prayer,[4] prosecuting the defendants under the manslaughter statute violated the due process requirement that a statute must not be vague and must provide adequate notice of the prohibited conduct.[5] In finding that the prosecution violated the Due Process Clause, the court also relied on a related due process argument that the government may not prosecute a defendant for conduct after the government has led a defendant into believing that such conduct is permitted.[6] The Supreme Court's denial of certiorari created great uncertainty as to the future of manslaughter prosecutions of parents who unsuccessfully rely on prayer to treat their ill children, since the Supreme Court also denied certiorari in 1989 in *Walker v. Superior Court*,[7] a California case that reached the opposite result. In *Walker*, the court ruled that California's child neglect statute, which contains a prayer-treatment exemption,[8] is a welfare provision aimed at ensuring that children are provided with basic care,[9] whereas the state's involuntary manslaughter[10] and felony child endangerment[11] statutes are "designed to protect citizens from immediate and grievous bodily harm."[12] In light of these separate purposes, the court held that no due process notice problem was posed by prosecuting for child endangerment and manslaughter a parent who relied on prayer to treat her child.[13]

Forty-four states and the District of Columbia have some form of spiritual treatment exemption to their child abuse and neglect laws.[14] An appeal that likely will raise the due process arguments made by the *McKown* court has been filed in Massachusetts in the case of *Commonwealth v. Twitchell*.[15] In this well-publicized

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[4] MINN. STAT. § 609.378 (1991).
[5] *McKown*, 475 N.W.2d at 67–69.
[6] *Id.* at 68–69.
[7] 763 P.2d 852 (Cal. 1988), *cert. denied*, 491 U.S. 905 (1989).
[8] CAL. PENAL CODE § 270 (1988 & West Supp. 1992).
[9] *Walker*, 763 P.2d at 856–63.
[10] CAL. PENAL CODE § 192(b).
[11] *Id.* § 273(a)(1).
[12] *Walker*, 763 P.2d at 860.
[13] *Id.* at 873.
[14] *See infra* notes 41–45.
[15] Commonwealth v. Twitchell, No. 89-210 (Mass. Dist. Ct. 1989). Notice of appeal has been filed, and the Twitchells' attorney has informed the author that the Twitchells intend to make a due process argument part of their appeal. Interview with Steven M. Umin, Esq., October 14, 1992 [hereinafter Umin Interview].

case,[16] two Christian Scientist parents were convicted of manslaughter for the death of their son, who died of an intestinal obstruction that, as doctors testified, was easily treatable. The Twitchells used a Christian Scientist practitioner to treat their child. Massachusetts's child neglect statute contains a prayer-treatment exemption.[17]

In Florida, an intermediate appellate court adopted the reasoning of the California Supreme Court in *Walker* to uphold the third-degree murder conviction of two Christian Scientist parents for the death of their daughter.[18] However, the Florida Supreme Court reversed the lower court's decision, repudiating *Walker* and relying instead upon the Minnesota Supreme Court's reasoning in *McKown*.[19]

None of the cases has provided a sufficiently thorough analysis of the due process issues. The void-for-vagueness doctrine is a shifting and ephemeral doctrine, well-established in constitutional theory, but used sparingly and unpredictably. As many commentators have noted, courts often invoke the doctrine not merely to protect against vagueness as such, but also to protect some underlying value, such as free speech, freedom of religion, or the right to abortion.[20] It has also been used with increasing frequency to protect citizens from unfair treatment when they could not determine what was expected of them by the law.

The due process doctrine of excusing those who misinterpret the law in reliance on the government is also universally accepted but infrequently applied. The doctrine is founded on two cases, *Raley v. Ohio*[21] and *Cox v. Louisiana*,[22] both cited by the court in *McKown*.[23] In these cases, the Supreme Court barred the prosecution of defendants who had relied, in *Raley*, on the erroneous advice of a state legislative committee as to their right against self-incrimination,[24] and in *Cox*, on erroneous instruc-

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[16] *See, e.g.*, David Margolick, *In Child Deaths, a Test for Christian Science*, N.Y. TIMES, Aug. 6, 1990, at A1, A11; Alain Sanders, *Convicted of Relying on Prayer*, TIME, July 16, 1990, at 52. The case may have received so much attention because Boston is the location of the headquarters of the First Church of Christ, Scientist.

[17] MASS. GEN. L. ch. 273, § 1 (1990).

[18] Hermanson v. State, 570 So. 2d 322 (Fla. Dist. Ct. App. 1990), *rev'd*, 604 So. 2d 775 (Fla. 1992).

[19] Hermanson v. State, 604 So. 2d 775 (Fla. 1992).

[20] *See, e.g.*, *infra* notes 208–209, 273–289.

[21] 360 U.S. 423 (1959).

[22] 379 U.S. 559 (1965).

[23] State v. McKown, 475 N.W.2d 63, 68 (Minn. 1991), *cert. denied*, 112 S. Ct. 882 (1992).

[24] *Raley*, 360 U.S. at 438–40.

tions from a police chief regarding where protesters could stand outside a courthouse to avoid violating an anti-protesting statute.[25] The doctrine is sparingly applied, in part because it runs contrary to the common law maxim *ignorantia legis non excusat* (ignorance of the law is no excuse).

This Note analyzes the Christian Scientist cases in light of these two broad doctrinal categories. While this Note takes the two categories in turn, the doctrines are closely related and interlocking, and thus one should not place too much significance on their structural separation for purposes of this Note.

Part I begins with a survey of the prayer-treatment exemptions in forty-four states and the District of Columbia. This is followed by a review of the cases that have ruled on the vagueness and reliance issues in the context of the prosecution of Christian Scientist parents for manslaughter. Part I also contains a brief discussion of the Free Exercise and Establishment Clause issues involved in these cases. The question whether manslaughter prosecutions violate the free exercise rights of parents who rely on spiritual means, as well as the question whether the prayer exemptions to the child abuse and neglect statutes violate the Establishment Clause, are beyond the scope of this Note, and they have been dealt with adequately elsewhere.[26] However, as noted above, external values inform vagueness and reliance analysis, and therefore this Note's analysis of the due process issues is inseparable from the related First Amendment considerations.

Similarly, the general propriety of exempting parents from manslaughter prosecutions as a matter of social policy has been dealt with at length in the press and in academic journals.[27] There are strong policy arguments on both sides. From one

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[25] *Cox*, 379 U.S. at 569–71.

[26] *See, e.g.*, Norval Morris, *The Watching Brief*, 54 U. CHI. L. REV. 1215 (1987) (addressing these issues in a fictional story); Christine A. Clark, Note, *Religious Accommodation and Criminal Liability*, 17 FLA. ST. U. L. REV. 559 (1990); JoAnna A. Gekas, Note, *California's Prayer Healing Dilemma*, 14 HASTINGS CONST. L.Q. 395 (1987); Daniel J. Kearney, Note, *Parental Failure to Provide Child with Medical Assistance Based on Religious Beliefs Causing Child's Death—Involuntary Manslaughter in Pennsylvania*, 90 DICK. L. REV. 861 (1986); Judith I. Schneiderer, Note, *When Children Die as a Result of Religious Practices*, 51 OHIO ST. L.J. 1429 (1990); Edward E. Smith, Note, *The Criminalization of Belief: When Free Exercise Isn't*, 42 HASTINGS L.J. 1491 (1991).

[27] Mark Curriden, *Blood, the Bible and the Law*, BARRISTER, Fall 1990, at 13; Margolick, *supra* note 16, at A1; Monica Moske, *Care of Children Fuels Christian Science Debate*, NEWARK STAR-LEDGER, Sept. 22, 1991, § 1, at 37; Elizabeth Neuffer, *Spiritual Healing: A Debate of Rights*, BOSTON GLOBE, May 22, 1990, at 1.

perspective, it is wrong to allow parents to jeopardize their children's lives by imposing their own religious views on them. On the other hand, one might question the propriety of prosecuting loving parents who believed their actions were the most promising method of healing their child, when so many malicious and abusive parents remain free from deserved punishment. While not the subject of this Note, such policy arguments undoubtedly color one's approach to the due process issue and will be addressed sporadically throughout.

Part II attempts to analyze the void-for-vagueness doctrine more thoroughly than the prayer exemption cases have. This Part is divided into four sections. It begins with an examination of the void-for-vagueness doctrine generally: the development of the doctrine, the classic cases, and the current status of the doctrine. This is followed by an analysis of the branch of the doctrine based on *Bouie v. City of Columbia*,[28] which holds that where a statute is narrow and precise, defendants are entitled to rely on it and their conduct cannot be declared illegal by subsequent judicial enlargement of the statute. While reliance upon a precise law is the inverse of confusion due to a vague one, both problems concern a potential defendant's perceptions of scope and applicability and are thus put in the same doctrinal category by the courts. The third section examines another special application of the vagueness doctrine—cases striking down statutes that give contradictory commands. The final section addresses the issue of vagueness analysis in cases involving statutes and ordinances that touch upon religious freedom.

Part III analyzes the *Raley/Cox* reliance doctrine. It begins with an examination of the common law maxim that ignorance of the law is no excuse, to which the *Raley/Cox* doctrine is an exception. It then traces the development of the doctrine and its current use in the lower federal courts, where it is called "entrapment by estoppel." This Part also will explore the relevance to this issue of the many state statutes that provide a mistake of law defense for defendants who rely on government pronouncements of the law and conform their conduct accordingly.

In Part IV, I will argue in conclusion that the intersection of the vagueness and reliance doctrines in the prayer-treatment exemption/manslaughter cases demonstrates that the prosecu-

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[28] 378 U.S. 347 (1964).

tions violate due process, and I will recommend statutory changes to bring the statutory schemes into compliance with the Constitution and with our fundamental notions of fairness.

I. The Prayer-Treatment Statutes and the Manslaughter Cases

A. *The Statutes*

Forty-four states and the District of Columbia provide an exemption to their child abuse and neglect laws for spiritual treatment. Of these jurisdictions, twenty-two have exemptions to the criminal child abuse or neglect statutes in their criminal codes.[29] Exemptions in the remaining twenty-three jurisdictions are contained in various civil and regulatory statutes, such as the states' child abuse reporting statutes,[30] termination of parental rights statutes, and similar statutory schemes.[31] Many states do not have statutes in their criminal codes specifically criminalizing child abuse and neglect. They rely instead on general criminal statutes, such as those against assault, and on the various regulatory remedies for protecting children from abuse.[32] However, regulatory schemes such as reporting statutes

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[29] *See infra* notes 41–43. Many of these states also have reporting statutes and other child welfare statutes with prayer-treatment exemptions. *See, e.g.*, ALASKA STAT. § 47.17.020(8)(d) (1991); COLO. REV. STAT. § 19-3-103 (1991); MINN. STAT. § 626.556 (1991). However, because the exemptions in the criminal statutes are more directly relevant to the problem of notice of proper parental conduct for purposes of the manslaughter statutes, where a state has an exemption in its criminal abuse or neglect statute, I have not listed exemptions in the state's other statutes.

[30] All 50 states have enacted reporting statutes. John E.B. Meyers, *A Survey of Child Abuse and Neglect Reporting Statutes*, 10 J. JUV. L. 1, 2 (1986). The substance of these statutes varies, but in general they are comprehensive statutory schemes providing means for the reporting, investigation, and resolution of child abuse cases. *See* IRVING J. SLOAN, CHILD ABUSE: GOVERNING LAW & LEGISLATION 15–17 (1983); Douglas J. Besharov, *The Legal Aspects of Reporting Known and Suspected Child Abuse and Neglect*, 23 VILL. L. REV. 458, 460 (1978).

[31] *See infra* notes 44–45.

[32] SLOAN, *supra* note 30, at 79; *see also* INSTITUTE OF JUDICIAL ADMINISTRATION/AMERICAN BAR ASSOCIATION, JUVENILE JUSTICE STANDARDS PROJECTS, STANDARDS RELATING TO ABUSE AND NEGLECT—TENTATIVE DRAFT (1977), *quoted in* HOWARD A. DAVIDSON ET AL., CHILD ABUSE AND NEGLECT LITIGATION: A MANUAL FOR JUDGES 142 (1981).

often contain criminal sanctions, including those against persons who fail to report abuse when the statute creates such a duty.[33]

Many states passed their spiritual treatment exemptions in order to comply with regulations of the Department of Health, Education, and Welfare ("HEW") promulgated pursuant to the Child Abuse Prevention and Treatment Act of 1974.[34] These regulations required that a state include a prayer-treatment exemption in its reporting scheme in order to receive federal matching funds.[35] The regulation originally required states to include the following provision in their definition of "harm or threatened harm to a child's health or welfare":

> [A] parent or guardian legitimately practicing his religious beliefs who thereby does not provide specified medical treatment for a child, for that reason alone shall not be considered a negligent parent or guardian; *However*, such an exception shall not preclude a court from ordering that medical services be provided to the child, where his health requires it.[36]

This language mirrored language in the House committee report for the Act.[37] This religious exemption requirement was eliminated when the final version of the rule was published in 1983.[38] The Department of Health and Human Services noted that the deletion was not intended as any substantive statement about the desirability of exemptions, saying that the deletion merely

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[33] *See* Meyers, *supra* note 30 at 6, 8. Such statutes, while providing criminal sanctions as an ancillary element of the child welfare regulatory scheme, are classified for purposes of this Note with the child welfare statutes rather than the criminal abuse and neglect statutes.

[34] 42 U.S.C. § 5101 (1991); *see also* Clark, *supra* note 26, at 565; John T. Gathings, Note, *When Rights Clash: The Conflict Between a Parent's Right to Free Exercise of Religion Versus His Child's Right to Life*, 19 CUMB. L. REV. 585, 591 (1989).

[35] Clark, *supra* note 26, at 565; Gathings, *supra* note 34, at 592. The requirement that states enact a religious-treatment exemption as a condition for receiving federal funds was, according to one news article, engineered by President Nixon's aides John Ehrlichman and H. R. Haldeman, both of whom are Christian Scientists. Rita Ciolli, *Faith vs. Law: Christian Scientists on Trial in Baby's Death*, NEWSDAY, Apr. 29, 1990, at 5.

[36] Child Abuse and Neglect Prevention and Treatment Program, 39 Fed. Reg. 43,937 (1974).

[37] The committee report stated:

> [I]t is not the intent of the Committee that a parent or guardian legitimately practicing his religious beliefs who thereby does not provide specific medical treatment for a child is *for that reason alone* considered to be a negligent parent. To clarify further, no parent or guardian who in good faith is providing to a child treatment by spiritual means—such as prayer—according to the tenets and practices of a recognized church through a duly accredited practitioner shall *for that reason alone* be considered to have neglected the child.

H.R. REP. No. 685, 93d Cong., 1st Sess. 4, 5 (1973), *reprinted in* 1974 U.S.C.C.A.N. 2763, 2767.

[38] *See* Child Abuse Prevention and Treatment Program, 45 C.F.R. § 1340 (1991); Clark, *supra* note 26, at 566; Gathings, *supra* note 34, at 591.

"reflected our approach to regulating."[39] While no states have repealed their exemptions in response to the elimination of this requirement, there are campaigns for their repeal in many states.[40]

The exemption statutes take a variety of forms. Turning first to the exemptions found in the criminal codes of twenty-two states, thirteen adopt language similar to that in the HEW regulation, stating that a parent does not abuse a child "for the sole reason that" the child is treated by spiritual means.[41] Nine use stronger language, stating that spiritual treatment shall constitute health care[42] or that spiritual treatment is a defense to prosecution.[43] The "for the sole reason" language is somewhat ambiguous. It must permit more than just the invocation of spiritual treatment, and shelter some acts and omissions by the parent, or it would be meaningless. Yet it is unclear under these thirteen states' statutes just how much spiritual treatment may displace medical care. Spiritual treatment, to Christian Scientists at least, means spiritual treatment to the exclusion of all medical treatment. A broad, but plausible, reading of the "solely" language is that the exemption does not immunize the parents practicing spiritual treatment from child neglect or abuse generally, such as if the parent did not provide adequate food or shelter, but immunizes them from neglect for failure to supply

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[39] 45 C.F.R. § 1340.

[40] Margolick, *supra* note 16, at A1.

[41] ALA. CODE § 13A-13-6(b) (1990); ARK. CODE ANN. § 5-27-221(c) (Michie 1991); COLO. REV. STAT. §§ 18-6-401, 19-1-114, 19-3-103 (1991); IDAHO CODE § 18-401(2) (1991); KAN. STAT. ANN. § 21-3608(1)(c) (1992); ME. REV. STAT. ANN. tit. 17-A, § 557 (West 1991); MASS. GEN. L. ch. 273, § 1(4) (1992); NEV. REV. STAT. ANN. § 200.5085 (Michie 1991); OKLA. STAT. tit. 21 §§ 852.1(B), 852.1(B) (1991); S.D. CODIFIED LAWS ANN. §§ 25-7-16, -7-17.1 (1991); TENN. CODE ANN. § 37-1-157 (c) (1991); VA. CODE ANN. §§ 18.2-314, -371.1(B) (Michie 1991); WIS. STAT. §§ 448.03(6), 948.03(6) (1991–1992). For example, the Massachusetts exemption states that "[a] child shall not be deemed to be neglected or lack proper physical care for the sole reason that he is being provided remedial treatment by spiritual means alone in accordance with the tenets and practice of a recognized church or religious denomination by a duly accredited practitioner thereof." MASS. GEN. L. ch. 273, § 1(4).

[42] ALASKA STAT. § 11.51.120(b) (1991); CAL. PENAL CODE § 270 (West 1992); MINN. STAT. § 609.378(a)(1) (1992); OHIO REV. CODE ANN. § 2919.22(A) (Baldwin 1992). For example, Minnesota's exemption to its child neglect and endangerment statute states that spiritual treatment or care "is 'health care,' for purposes of this clause." MINN. STAT. § 609.378(a)(1).

[43] DEL. CODE ANN. tit. 11 § 1104 (1991); IND. CODE § 35-46-1-4(4), -5(c) (1988); N.H. REV. STAT. ANN. § 639:3 (West 1990); N.Y. PENAL LAW § 260.15 (McKinney 1992); UTAH CODE ANN. § 78-3a-19.5 (1991). For example, Indiana's child neglect statute states that "[i]t is a defense that the accused person, in the legitimate practice of his religious belief, provided treatment by spiritual means through prayer, in lieu of medical care, to his dependent child." IND. CODE § 35-46-1-5(c).

medical care. A narrower reading is also possible, however. The "solely" language might permit some degree of spiritual treatment, while reserving the power to question whether certain withholdings of medical care to a child being treated through spiritual means are too extreme to be protected and thus may be judged independently of the exemption.

Turning to the twenty-three jurisdictions with prayer exemptions only to their child abuse reporting statutes and other regulatory schemes, all but one employ language such as "solely for the reason."[44] North Dakota provides a broader exemption, but the statute is confusing at first glance since it also uses the word "solely." The exemption states that a parent has not neglected or abused a child when the suspected abuse or neglect "arises solely out of conduct involving the legitimate practice of religious beliefs."[45] Protecting all conduct that "involves" religious beliefs would seem to prevent finding parents abusive or neglectful for any acts or omissions involving the spiritual treatment of a child's illness.

Varied language is used to define what constitutes spiritual treatment for purposes of the exemptions, both among states with exemptions in their criminal codes and jurisdictions with other exemptions. Five specify an exemption for Christian Scientists by name.[46] Fifteen states exempt parents who treat their children according to the tenets of a "recognized" church by a "duly accredited practitioner."[47] States imposing this latter re-

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[44] ARIZ. REV. STAT. ANN. §§ 8-546(B), 8-531.01 (1991); CONN. GEN. STAT. §§ 17a-104, 46b-120 (1992); D.C. CODE ANN. §§ 2-1356, 16-2301(8)(f) (1991); FLA. STAT. ch. 415.503(f) (1992); GA. CODE ANN. § 15-11-2(8)(D) (Michie 1991); HAW. REV. STAT. § 350-4 (1991); ILL. REV. STAT. ch. 23, paras. 2053, 2054 (1991); IOWA CODE § 232.68(2)(c) (1992); LA. REV. STAT. ANN. § 14:403(B)(5) (West 1992); MD. FAM. LAW CODE ANN. § 5-701(n)(2) (1991); MICH. COMP. LAWS § 722.634 (1979); MISS. CODE ANN. § 43-21-105(l) (1991); MO. REV. STAT. § 210.115(3) (1992); N.J. STAT. ANN. § 9:6-81.21 (West 1991); N.M. STAT. ANN. § 32-1-3(L)(5) (Michie 1991); OR. REV. STAT. § 418.740(e) (1989); 23 PA. CONS. STAT. § 6303 (1991); R.I. GEN. LAWS § 40-11-15 (1990); VT. STAT. ANN. tit. 33, § 4912(3)(c) (1991); WASH. REV. CODE § 26.44.020(3) (1992); W. VA. CODE § 49-1-3 (1991); WYO. STAT. § 14-3-202(a)(vii) (1991).

[45] N.D. CENT. CODE § 50-25.1-05.1(2) (1991).

[46] ARIZ. REV. STAT. ANN. §§ 8-531.01, 8-546(B); CONN. GEN. STAT. § 17a-104; VA. CODE ANN. § 18.2-314; WASH. REV. CODE § 26.44.020(3); WIS. STAT. §§ 448.03(6), 948.03(6). Arizona's exemption statute, for example, reads: "Notwithstanding any other provision of this chapter, no child who in good faith is being furnished christian science treatment by a duly accredited practitioner shall, for that reason alone, be considered to be an abused, neglected or dependent child." ARIZ. REV. STAT. ANN. § 8-531.01.

[47] ALA. CODE § 13A-13-6; ALASKA STAT. § 11.51.120(b); ARK. CODE ANN. § 5-27-221(3)(c); CAL. PENAL CODE § 270; COLO. REV. STAT. § 19-1-114; D.C. CODE ANN. §§ 2-1356, 16-2301(8); GA. CODE ANN. § 15-11-2(8)(D); HAW. REV. STAT. § 350-4; MASS. GEN. L. ch. 273 § 1; MISS. CODE ANN. § 43-21-105(i); N.J. STAT. ANN. § 9:6-81.21; N.M. STAT. ANN. § 32-1-3(L)(5); 23 PA. CONS. STAT. § 6303; VA. CODE ANN.

quirement effectively limit the exemption to Christian Scientists, as do the two states that exempt parents who treat their children through a recognized or proven method of healing,[48] and the three that provide an exemption for healing methods otherwise recognized by state law,[49] since the Christian Scientist church is the most widely known church using prayer healing and its practitioners are often regulated by state law.[50] A broader formulation, found in eight states, extends the exemption to those who practice spiritual treatment according to the tenets of any recognized religious denomination.[51] Sixteen statutes exempt all spiritual treatment or that which is "legitimate" or in "good faith."[52]

Six of the states with prayer exemptions found exclusively in their child welfare statutes provide that the exemption shall not preclude a court from ordering medical treatment for the child.[53]

§ 16.1-228; WYO. STAT. § 14-3-202(a)(vii). The Massachusetts exemption statute states, for example, that "[a] child shall not be deemed to be neglected or lack proper physical care for the sole reason that he is being provided remedial treatment by spiritual means alone in accordance with the tenets and practice of a recognized church or religious denomination by a duly accredited practitioner thereof." MASS. GEN. L. ch. 273 § 1(4).

[48] COLO. REV. STAT. §§ 14-6-101(2), 19-3-201(2)(b) (1991); LA. REV. STAT. ANN. § 14:403(B)(5) (West 1992). Louisiana's statute reads: "Whenever, in lieu of medical care, a child is being provided treatment in accordance with the tenets of a well-recognized religious method of healing which has a reasonable proven record of success, the child shall not for that reason alone be considered to be neglected or abused." LA. REV. STAT. ANN. § 14:403(B)(5).

[49] MD. FAM. LAW CODE ANN. § 5-701(n); NEV. REV. STAT. ANN. § 200.5085; TENN. CODE ANN. § 37-1-157(c).

[50] For example, Maryland's health occupations law specifically exempts from laws regulating accepting a fee for treatment of patients "[a] Christian Science practitioner, who is accredited by the First Church of Christ, Scientist, in Boston, Massachusetts." MD. HEALTH OCC. CODE ANN. § 14-102(a)(2) (1991); *see also* TENN. CODE ANN. § 68-11-217 (referring to "First Church of Christ, Scientist, in Boston, Massachusetts").

[51] DEL. CODE ANN. tit. 11 § 1104 (1991); KAN. STAT. ANN. § 21-3608(1)(c); N.H. REV. STAT. ANN. § 639:3(4); N.Y. PENAL LAW § 260.15; OHIO REV. CODE ANN. § 2919.22(A) (Baldwin 1992); OKLA. STAT. tit. 21 § 852 (A); VA. CODE ANN. § 18.2-371.1(B); W. VA. CODE § 49-1-3(g)(2)(A). New York, for example, requires that the defendants be members of an organized church "the tenets of which prescribe prayer as the principal treatment for illness." N.Y. PENAL LAW § 260.15.

[52] FLA. STAT. ch. 415.503(8)(f); IDAHO CODE § 18-401(2); ILL. REV. STAT. ch. 23, paras. 2053, 2054; IND. CODE § 35-46-1-4(4), -5(c); IOWA CODE § 232.68(2)(c); ME. REV. STAT. ANN. tit. 17-A § 557; MICH. COMP. LAWS § 722.634; MINN. STAT. § 609.378(a); MO. REV. STAT. § 210.115(3); N.D. CENT. CODE § 50-25.1-05.1(2); OKLA. STAT. tit. 21, § 852.1(B); OR. REV. STAT. § 418.740(e); R.I. GEN. LAWS § 40-11-15; S.D. CODIFIED LAWS ANN. § 25-7-16; UTAH CODE ANN. § 78-3a-19.5; VT. STAT. ANN. tit. 33, § 4912(3)(c). Maine's exemption reads: "For the purposes of this chapter, a person who in good faith provides treatment for a child or incompetent person by spiritual means through prayer alone shall not for that reason alone be deemed to have knowingly endangered the welfare of such child or incompetent person." ME. REV. STAT. ANN. tit. 17-A § 557.

[53] FLA. STAT. ch. 415.503; IOWA CODE § 232.68(2)(c); MICH. COMP. LAWS § 722.634; MO. REV. STAT. § 210.115(3); N.D. CENT. CODE § 50-25.1-05.1(2); R.I. GEN. LAWS § 40-11-15.

Only two of the exemptions to criminal abuse or neglect statutes specifically reserve the right of a court to order treatment.[54] However, two other states with criminal exemptions also have reporting statutes that contain such a provision, although the criminal statute makes no cross-reference.[55] By reserving a right to intervene, states with a prayer exemption to their criminal abuse and neglect statutes may exempt a parent from criminal sanctions without going so far as to equate spiritual treatment with medical care. Similarly, in states that provide for court intervention in the prayer exemption to their child welfare laws, there appears to be only a policy of accommodating the parents' religious beliefs and treatment decisions, without calling such treatment sufficient in all circumstances.

Only one state, Oklahoma, specifies that the prayer exemption in its criminal child neglect statute does not extend to those cases "where permanent physical damage could result to such child."[56] Thus Oklahoma parents are on notice that they may be held liable for manslaughter if their child dies as a result of their exclusive reliance upon spiritual treatment.

B. *The Manslaughter Cases and Due Process:* McKown, Walker, *and* Hermanson

As noted in the introduction, courts in Minnesota,[57] California,[58] and Florida[59] have ruled on the constitutionality of prosecuting for manslaughter or felony child endangerment parents

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[54] OKLA. STAT. tit. 21 § 852(A); S.D. CODIFIED LAWS ANN. § 25-7-16.

[55] COLO. REV. STAT. 19-3-103(1); IDAHO CODE § 16-1602(n)(1).

[56] OKLA. STAT. tit. 21, § 852(A). Colorado, which also provides a prayer exemption to its criminal neglect statute, provides in its reporting statute that "the religious rights of a parent . . . shall not limit the access of a child to medical care in a life-threatening situation or when the condition will result in serious handicap or disability. . . . [In such cases] the court may . . . order that medical treatment be provided for the child." COLO. REV. STAT. § 19-3-103(1).

[57] State v. McKown, 475 N.W.2d 63 (Minn. 1991), *cert. denied,* 112 S. Ct. 882 (1992).

[58] Walker v. Superior Court, 763 P.2d 852 (Cal. 1988), *cert. denied,* 491 U.S. 905 (1989); *see also* State v. Rippberger, 231 Cal. App.3d 1667 (1991) (upholding child endangerment conviction of two Christian Scientist parents whose prayer treatment failed to save their eight-month-old daughter, and further holding that the conviction did not violate the parents' rights to free exercise of religion).

[59] Hermanson v. State, 604 So. 2d 775 (Fla. 1992).

who relied or might have relied on those states' prayer-treatment exemptions.[60]

1. Statutory Construction

While the courts in *McKown* ruled that a manslaughter prosecution would violate the Due Process Clause of the United States Constitution and the court in *Walker* did not, both courts were in agreement that as a matter of statutory construction, the prayer-treatment exemption to the Minnesota child neglect act[61] does not extend to the manslaughter statute.[62] While the Florida Supreme Court did not address the statutory construction argument in *Hermanson,* the Florida District Court of Appeal agreed with the *McKown* and *Walker* courts on this issue. The trial court in *McKown* had ruled that the two statutes were *in pari materia* and thus must be construed together to provide defendants with a prayer-treatment exemption to manslaughter prosecution.[63] Both the Minnesota Court of Appeals[64] and the Minnesota Supreme Court rejected this argument. The Minnesota Supreme Court noted that "[s]tatutes *in pari materia* are those relating to the same person or thing or having a common purpose [and] should be construed in light of one another."[65] The court observed that the child neglect statute applies only

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[60] A similar due process challenge was made by the defendants on appeal in Bergmann v. State, 486 N.E.2d 653, 661 (Ind. Ct. App. 1985), but the court ruled that they had waived the issue by failing to raise it at trial and in their motion to correct errors. In Commonwealth v. Barnhart, 497 A.2d 616 (Pa. Super. Ct. 1985), *appeal denied,* 538 A.2d 874 (Pa.), *cert. denied,* 488 U.S. 817 (1988), the Superior Court of Pennsylvania held that defendants' "attempted reliance on the [child abuse reporting act exemption] is misplaced," since child abuse reporting was not at issue in defendants' manslaughter and child endangerment convictions. *Id.* at 628. The court did not elaborate on whether it was referring to reliance as a matter of statutory construction, as an element of reasonableness, or as an issue of due process. The due process issue was raised by defense counsel during a negligent homicide trial of a parent practicing religious treatment for her child in Louisiana, but the case ended in a mistrial when the jury could not reach a unanimous verdict. *See* Lawrence J. Goodrich, *Louisiana Mistrial and Spiritual Healing,* CHRISTIAN SCI. MONITOR, Dec. 5, 1990, at 5.

[61] "If a parent, guardian, or caretaker responsible for the child's care in good faith selects and depends upon spiritual means or prayer for treatment or care of disease or remedial care of the child, this treatment or care is 'health care' . . . ." MINN. STAT. § 609.378(1)(A).

[62] The state's manslaughter statute, MINN. STAT. § 609.205(1), does not mention religion or prayer.

[63] State v. McKown, 461 N.W.2d 720, 722 (Minn. Ct. App. 1990), *rev'd,* 475 N.W.2d 63 (Minn. 1991), *cert. denied,* 112 S. Ct. 882 (1992).

[64] *Id.* at 722–23.

[65] State v. McKown, 475 N.W.2d 63, 65 (Minn. 1991), *cert. denied,* 112 S. Ct. 882 (1992).

to those who have legal responsibility for a child, whereas the second degree manslaughter statute "permits the state to prosecute anyone who causes the death of another by exposing that person to an unreasonable risk of death or great bodily injury."[66] Thus, the court held, the two statutes have different purposes. Furthermore, it noted, there is no reference in either statute to the other, nor is the language of the statutes similar enough to suggest an implicit cross reference.[67] Therefore, the court rejected the defendants' claim that they were entitled to a statutory exemption from prosecution for manslaughter for conforming their actions to the standard outlined in the exemption to the child neglect statute.[68]

The *Walker* court also concluded as a matter of statutory construction that the defendants were not entitled to raise the prayer exemption as a defense. The court held that the California child neglect statute[69] and the involuntary manslaughter[70] and child endangerment[71] statutes had entirely different aims: manslaughter and endangerment are not merely more severe forms of neglect. The court stated that "rather than punishment of neglectful parents, the principal statutory objectives [of the neglect statute] are to secure support of the child and to protect the public from the burden of supporting a child who has a parent able to support him."[72] The court noted that the child

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[66] *Id.* at 66.

[67] *Id.*

[68] *Id.* at 67. The Minnesota Court of Appeals, in addition to finding that the manslaughter statute was much broader in scope than the child neglect statute, also based its decision on the ambiguous legislative history of the two provisions. *See McKown*, 461 N.W.2d at 723.

[69] CAL. PENAL CODE § 270 (1988 & West Supp. 1992). The statute states in pertinent part:

> If a parent of a minor child willfully omits, without lawful excuse, to furnish necessary clothing, food, shelter or medical attendance, or other remedial care for his or her child, he or she is guilty of a misdemeanor . . . .
>
> . . . .
>
> If a parent provides a minor with treatment by spiritual means through prayer alone in accordance with the tenets and practices of a recognized church or religious denomination, by a duly accredited practitioner thereof, such treatment shall constitute "other remedial care," as used in this section.

Id.

[70] *Id.* § 192(b).

[71] *Id.* § 273a(1).

[72] Walker v. Superior Court, 763 P.2d 852, 859 (Cal. 1988) (quoting People v. Sorensen, 68 Cal.2d 280, 287 (1968)). Professor Laurence Tribe has argued that the court misunderstood the purpose of the child neglect statute. He notes that in California prior to the *Walker* case, every prosecution of parents whose child died while being treated by spiritual means was brought under the child neglect statute. Petition for Certiorari at 12, Walker v. Superior Court, 763 P.2d 852 (Cal. 1988), *petition for cert. filed*, 57

endangerment and manslaughter statutes, in contrast, were "designed to protect citizens from immediate and grievous bodily harm."[73] The court thus argued that the statutes need not be construed together. The court noted further that there is an exemption to the child neglect statute for people who cannot afford medical care for their children, but there is no such exemption to the manslaughter statute.[74] This last argument, however, merely begs the question.

The Florida District Court of Appeal in *Hermanson* also rejected the statutory construction argument that the prayer-treatment exemption[75] in the state's comprehensive child protection statute[76] should be applied to the felony child abuse and third-degree murder statutes as well.[77] Similarly, the Indiana Supreme Court, in a case that did not reach the due process question,[78] held that, as a matter of statutory construction, it was not a defense to reckless homicide[79] that a child was treated with prayer in accordance with the prayer-treatment exemption to that state's felony child neglect statute.[80] The trial court in the *Twitchell* case appears to have made a similar determination.[81]

U.S.L.W. 3622 (U.S. Mar. 8, 1989) (No. 88-1471) [hereinafter Tribe Petition]. Furthermore, the statement that this statute is not aimed at punishment is rather disingenuous. The same rhetorical trick could be applied to any area of the criminal law. For example, one could say that laws making it criminal not to file taxes are not aimed at punishing non-filing persons but at ensuring that the coffers of the treasury are full. While this may be true in part, one also would have to say that a purpose of the law is to compel people to file their taxes and punish them when they do not. The court may mean that we view with greater moral condemnation those who endanger their children or commit involuntary manslaughter than we do those who merely neglect their children. But surely there is some degree of moral condemnation aimed at those who neglect their children. More fundamentally, one would have a hard time convincing someone convicted of and sentenced for the misdemeanor offense of child neglect that he was not being punished. If, on the other hand, one adopts a strictly utilitarian view, then there is no basis for distinguishing between child abuse and manslaughter statutes, except in degree.

[73] *Walker*, 763 P.2d at 860.

[74] *Id.*

[75] FLA. STAT. ANN. § 415.503(9)(f).

[76] *Id.* §§ 415.502–.514.

[77] Hermanson v. State, 570 So. 2d 322, 327–31 (Fla. Dist. Ct. 1990), *rev'd*, 604 So. 2d 775 (Fla. 1992).

[78] Hall v. State, 493 N.E.2d 433, 435 (Ind. 1986); *see also* the discussion of *Barnhart*, *supra* note 60.

[79] IND. CODE § 35-42-1-5.

[80] *Id.* § 35-46-1-4.

[81] The trial court in *Commonwealth v. Twitchell* excluded from the trial any reference to the child neglect statute. At this writing, the trial transcript is unavailable. This information came from the Twitchells' attorney. Umin Interview, *supra* note 13.

2. The *McKown* Decision

Despite holding that the statutes need not be construed together, the Minnesota Supreme Court[82] and the Minnesota Court of Appeals[83] affirmed the ruling of the trial court[84] that the prosecution of the defendants for manslaughter violated the Due Process Clause. The Minnesota Supreme Court thus upheld the trial court's order dismissing the McKowns' indictments. The court relied on two due process arguments. First, the court found that the statutes did not give fair notice of criminality, thereby violating due process in a manner similar to the vagueness doctrine. Second, the court held that the state actively, although unintentionally, had misled the defendants as to how they should act to avoid criminal liability.

Analyzing the fair notice argument, the court noted first that this was not a case in which the wording of the prohibited conduct was unclear.[85] Rather, the court held that it was the statutory exemption in the child neglect statute that was vague. The court wrote that the prayer exemption

> is broadly worded, stating that a parent may in good faith "select and depend upon" spiritual treatment and prayer, without indicating a point at which doing so will expose the parent to criminal liability . . . . The language of the exception therefore does not satisfy the fair notice requirement inherent to the concept of due process.[86]

The court stated that it had found no case directly on point. The court noted, however, that analogous reasoning had been applied in *United States v. Colon-Ortiz.*[87] In that case, the First Circuit stated that a federal criminal drug distribution statute[88] that set forth a penalty of imprisonment, fine, or both, and later in the same subparagraph seemed to require a mandatory prison sentence, did not give fair notice to the defendants of the penalty to which they would be subjected if they violated the statute.

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[82] State v. McKown, 475 N.W.2d 63, 67–69 (Minn. 1991), *cert. denied,* 112 S. Ct. 882 (1992).

[83] State v. McKown, 461 N.W.2d 720, 723–26 (Minn. Ct. App. 1990), *rev'd,* 475 N.W.2d 63 (Minn. 1991), *cert. denied,* 112 S. Ct. 882 (1992).

[84] *See id.* at 721.

[85] *McKown,* 475 N.W.2d at 67–68 (citing Kolender v. Lawson, 461 U.S. 352 (1983)).

[86] *Id.* at 68.

[87] 866 F.2d 6 (1st Cir.), *cert. denied,* 490 U.S. 1051 (1989).

[88] 21 U.S.C. § 841(b)(1)(B) (1992).

The court in *Colon-Ortiz*, citing two classic Supreme Court vagueness cases,[89] held that the statute as written did not give the fair notice required by the Due Process Clause.[90] However, the court in *Colon-Ortiz* gave the statute a saving construction and upheld the denial of the defendant's motion to dismiss.[91]

The court's second ground for dismissing the indictments of the McKowns was that the indictments "violate[d] the long-established rule that a government may not officially inform an individual that certain conduct is permitted and then prosecute the individual for engaging in that same conduct."[92] The court cited *Cox v. Louisiana*[93] and *Raley v. Ohio*[94] as authority.[95] In *Cox*, the Supreme Court ruled that protesters who had been told by a police chief that they must confine their protest to a portion of the street 101 feet from a courthouse could not be prosecuted under a statute prohibiting protests "near" a courthouse.[96] In *Raley*, the defendants were prosecuted for their refusal to answer questions while before a commission of the Ohio legislature under a grant of immunity. The members of the commission, through honest error, had told the defendants that they could claim the privilege against self-incrimination.[97] The Supreme Court overturned the convictions, calling what had occurred "the most indefensible sort of entrapment by the State—convicting a citizen for exercising a privilege which the State clearly had told him was available."[98]

The *McKown* court ruled that such entrapment had occurred when the state legislature passed an exemption that specifically

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[89] United States v. Harris, 347 U.S. 612 (1954); Connally v. General Constr. Co., 269 U.S. 385 (1926).

[90] *Colon-Ortiz*, 866 F.2d at 9–10.

[91] The court held that the legislative history of 21 U.S.C. § 841(b)(1)(B) clearly indicated that the statute was meant to contain a mandatory prison sentence. *Id.* The court thus held that the ambiguity was due to an inadvertent drafting error and struck the language suggesting that a fine could be imposed in place of a prison sentence. *Id.* at 10. The court also noted that the lower court would not have imposed the lighter sentence anyway. *Id.* at 10–11. For a scathing criticism of the First Circuit's rewriting of the federal statute in this case, see United States v. Preston, 739 F. Supp. 294 (W.D. Va. 1990) (ruling that the contradiction in 21 U.S.C. § 841(b)(1)(B) did not give the fair notice required by the Due Process Clause, and therefore the trial court judge must be given the discretion to impose a fine). Contradictions in sentencing schemes, and *Colon-Ortiz* and *Preston*, are discussed in greater detail *infra* part II.B.

[92] *McKown*, 475 N.W.2d at 68.

[93] 379 U.S. 559 (1965).

[94] 360 U.S. 423 (1959).

[95] *McKown*, 475 N.W.2d at 68.

[96] *Cox*, 379 U.S. at 568–72.

[97] *Raley*, 360 U.S. at 423–24.

[98] *Id.* at 438.

stated that Christian Scientist parents could "depend upon" spiritual treatment for their children, and that such "treatment shall constitute 'health care.'"[99]

Unlike *McKown*, the defendants in *Raley* and *Cox* were not misled by a statute. Rather, government officials directly misled the particular defendants. However, while the court did not discuss any other cases on this issue, cases subsequent to *Raley* and *Cox* make a persuasive argument that the principles of *Raley* and *Cox* should be applied to *McKown* and like cases.[100]

The Minnesota Court of Appeals in *McKown* provided a more elaborate analysis of the void-for-vagueness doctrine than did the Supreme Court of Minnesota. The court quoted *Connally v. General Constr. Co.*,[101] in which the Supreme Court held that "a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law."[102]

The court of appeals noted that the United States Supreme Court, in one of its most recent vagueness decisions, *Kolender v. Lawson*,[103] observed that there are two basic elements to the doctrine: notice to the defendants and the prevention of arbitrary enforcement. The Supreme Court explained that "the void-for-vagueness doctrine requires that a penal statute define the criminal offense with sufficient definiteness that ordinary people can understand what conduct is prohibited and in a manner that does not encourage arbitrary and discriminatory enforcement."[104] Turning to the notice question, the court of appeals held that "[t]he manslaughter statute gives no notice of when its broad proscription might override the seemingly contradictory permission given by the child neglect statute to treat the child by such spiritual means."[105] The court observed that the prosecutor had been unable to articulate the relationship of the manslaughter and child neglect statutes when asked to do so by

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[99] *McKown*, 475 N.W.2d at 64, 68.
[100] *See infra* part III.B.
[101] 269 U.S. 385 (1926).
[102] *Id.* at 391. In *Connally*, the Court invalidated as void for vagueness a law that made it a criminal offense for state contractors to pay "less than the current rate of per diem wages in the locality where the work is performed," because the definitions of "current rate" and "locality" were unclear. *Id.* at 388, 393–95.
[103] 461 U.S. 352 (1983) (invalidating California vagrancy statute as applied to defendant).
[104] *Id.* at 357.
[105] *McKown*, 461 N.W.2d at 723.

the grand jury.[106] The court also noted that the Oklahoma child abuse statute, in contrast, specifies the limits of the prayer-treatment exemption.[107] The court, quoting Justice Holmes's decision in *International Harvester Co. v. Kentucky*,[108] held that if parents who choose to treat their children in accordance with the prayer exemption were held liable for manslaughter, they would be "left to 'divine prophetically' the outcome of their actions, a 'gift[ ] that mankind does not possess.'"[109]

The court also noted the danger of arbitrary enforcement of the manslaughter statute, arguing that it would be absurd to suggest that parents who had chosen to treat a child who had cancer with chemotherapy, but whose child died nonetheless, would be prosecuted for manslaughter. The court wrote that "the state would have us conclude that the choice of spiritual treatment, which has been put on legal footing equal to that of orthodox medical care by the child neglect statute, can result in a manslaughter indictment, simply because of its outcome."[110] This, the court held, is unconstitutionally arbitrary.

The court also made a reliance argument similar to that made by the Minnesota Supreme Court. The court observed that, in addition to *Raley*, the Supreme Court, in *United States v. Cardiff*,[111] had struck down on vagueness grounds a statute that contained contradictory directives and therefore could mislead potential defendants.[112] The court recognized that in non-economic activities, people seldom consult the law and therefore in fact are not likely to be misled by the government through a statute. Indeed, the common law rule that all citizens are presumed to know the law certainly is a fiction.[113] However, the court noted, the common law principle of presumed knowledge of the law is reliable with regard to Christian Scientists and

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[106] *Id.* at 724.

[107] *Id.* at 723–24; *see also supra* note 56 and accompanying text (discussing the Oklahoma prayer-treatment exemption).

[108] 234 U.S. 216 (1914) (finding unconstitutionally vague a statutory scheme allowing collusion among businesses but holding colluding businesses criminally liable if prices exceed what they would have been absent the combination and absent other factors violently affecting prices).

[109] *McKown*, 461 N.W.2d at 724 (quoting *International Harvester*, 234 U.S. at 223–24).

[110] *Id.*

[111] 344 U.S. 174 (1952).

[112] *McKown*, 461 N.W.2d at 723. The court in *Cardiff* invalidated a food inspection law that "makes inspection dependent on consent and makes refusal to allow inspection a crime." *Cardiff*, 344 U.S. at 176; *see also infra* part II.B.

[113] *See infra* part III.A.

prayer-treatment exemptions. The court stated that "many Christian Scientists, including the McKowns, were specifically aware of the statutory provisions relating to use of spiritual means and prayer. They may indeed have 'mapped out' their behavior based upon the statute."[114]

3. *Walker*: The Rejection of the Due Process Argument

Unlike the *McKown* courts, the Supreme Court of California in *Walker* rejected the defendant's due process claim.[115] The court held that the manslaughter prosecution of the mother of the deceased child did not violate the arbitrary enforcement or notice aspects of the vagueness doctrine, nor was the *Raley* doctrine implicated.

The court first held that the two statutes did not fail to delineate sufficient standards to enable law enforcement officials to apply the law even handedly. The court held that law enforcement officials simply can focus on manslaughter and treat this case like any other.[116]

The court also rejected the argument that, viewed together, the manslaughter statute and the child neglect statute did not give parents using prayer treatment the required notice of what conduct was being made illegal. The defendant argued that the law did not provide any standard for assessing when lawful prayer treatment of a child crossed the court's threshold of criminal culpability, defined as "a disregard of human life or an indifference to consequences."[117] The court noted that the defendant had asked the rhetorical question: "Is it lawful for a parent to rely solely on treatment by spiritual means through prayer for the care of his/her child during the first few days of sickness but not for the fourth or fifth day?"[118]

In answer to this, the court quoted Justice Holmes's statement that "the law is full of instances where a man's fate depends on his estimating rightly, that is, as the jury subsequently estimates

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[114] *McKown*, 461 N.W.2d at 724–25. The First Church of Christ, Scientist publishes books and pamphlets describing parents' rights and obligations and discussing the spiritual-treatment exemptions. *See, e.g.*, FIRST CHURCH OF CHRIST, SCIENTIST, FREEDOM AND RESPONSIBILITY: CHRISTIAN SCIENCE HEALING FOR CHILDREN (1989).

[115] Walker v. Superior Court, 763 P.2d 852, 871–73 (Cal. 1988), *cert. denied*, 491 U.S. 905 (1989).

[116] *Id.* at 862.

[117] *Id.* at 866 (quoting People v. Penny, 44 Cal.2d 861, 879 (1955)).

[118] *Id.* at 872.

it, some matter of degree."[119] The *McKown* court, probably in response to this, quoted Justice Holmes for the opposite proposition, that it violates due process to require people to "divine prophetically" the outcome of their actions.[120]

The *Walker* court thus seems to have held that there is a point of severity at which a reasonable parent relying on prayer to heal a child would abandon spiritual treatment and seek medical attention. The court argued that the notice problem here is no different from the problem faced by any person estimating criminal liability under a sliding-scale standard such as "recklessness" or "negligence," where criminal liability is a question of degree. Professor Tribe, in his petition for certiorari in *Walker*, argued that letting the jury determine this point violated the Establishment Clause rule forbidding government inquiry into the validity of religious beliefs.[121]

The court also rejected the defendant's argument that the two statutes gave contradictory commands to the citizenry. The court maintained that we "require citizens to apprise themselves not only of statutory language but also of legislative history, subsequent judicial construction, and underlying legislative purposes."[122] The court thus said, in effect, that the statutes in and of themselves were not really commands by the state. Rather, the only commands upon which one may rely are those that a court, examining statutory language plus all of these other factors retrospectively, determines to have been the commands of the state to its subjects. This conclusion is at odds with the Supreme Court's decision in *Bouie v. City of Columbia*,[123] where the Court held that a defendant had a right to rely on "narrow and precise" statutory language, and therefore that a court cannot expand through judicial construction the compass of a statute upon which the defendant relies.[124]

The *Bouie* argument is particularly relevant in the *Walker* case, because prior to *Walker* every prosecution arising out of prayer healing in California had been brought under the child

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[119] Nash v. United States, 229 U.S. 373, 377 (1913).

[120] International Harvester Co. v. Kentucky, 234 U.S. 216, 223–24 (1914). The court of appeals in *McKown* also quoted the passage from *Nash* cited by the *Walker* court, but introduced it by noting that "this is not one of those cases identified by Justice Holmes." *McKown*, 461 N.W.2d at 725.

[121] Tribe Petition, *supra* note 72, at 21–22; *see also infra* notes 169–172 and accompanying text.

[122] *Walker*, 763 P.2d at 872.

[123] 378 U.S. 347 (1964).

[124] *Id.* at 352. *Bouie* is discussed in detail *infra* notes 251–272.

neglect statute (prior to the exemption), not under the manslaughter statute.[125] Thus there was no judicial construction which defendants could have consulted. Furthermore, there was nothing in the legislative history describing the relationship between the manslaughter statute and the child neglect statute.[126] *Walker*, then, would require potential defendants to predict how the court would interpret the state legislature's failure to describe explicitly the relationship of the two statutes. Imposing such a burden denies the defendants the minimum notice required by the Due Process Clause.

The *Walker* court also specifically rejected the defendant's invocation of *Raley* and *Cox*. The court refused to apply the doctrine to cases in which an official statement of the law is merely contradictory or confusing, rather than erroneous.[127]

4. *Hermanson*

In *Hermanson*, the third case to rule on the due process issue, the Florida Supreme Court adopted the reasoning of the *McKown* court, and specifically rejected *Walker*. In *Hermanson*, Christian Scientist parents were convicted of third-degree murder after they failed to provide their daughter with conventional medical treatment. The court reversed the convictions as violating due process. The court held that the spiritual treatment accomodation provision in Florida's child abuse reporting statute,[128] and the state's manslaughter provision,[129] "when considered together, are ambiguous and result in a denial of due process because the statutes in question fail to give parents notice of the point at which their reliance on spiritual treatment loses statutory approval and becomes culpably negligent."[130] The court also stated that "a person of ordinary intelligence cannot be expected to understand the extent to which reliance on spir-

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[125] *See* Tribe Petition, *supra* note 72, at 12.

[126] *Walker*, 763 P.2d at 863–66. The court observed that the staff analyses in the California Assembly and Senate raised the question of what the relationship of the two statutes would be, but legislators in both houses declined to comment on it. The court used this omission to argue that as a matter of statutory construction the two statutes should not be read together. *Id.*

[127] *Id.* at 872 n.18.

[128] FLA. STAT. ch. 415.503(7)(f) (1985).

[129] *Id.* ch. 827.04(1).

[130] Hermanson v. State, 604 So. 2d 775, 776 (Fla. 1992).

itual healing is permitted and the point at which this reliance constitutes a criminal offense under the subject statutes."[131]

The court's reasoning rested on both vagueness and reliance grounds. The court cited numerous Supreme Court vagueness cases, and concluded that the statutes failed to give fair warning of what conduct was prohibited. The court also focused on the fact that the government had misled the Hermansons. Citing the reliance discussion in *McKown*, but not specifically citing *Raley* and *Cox*, the court held that "[t]he statutes have created a trap"[132] for parents who rely on the prayer-treatment exemption. The court concluded that "[i]f the legislature desires to provide for religious accommodation while protecting the children of the state, the legislature must clearly indicate when a parent's conduct becomes criminal."[133]

5. *Twitchell*

The *Twitchell* case is currently on appeal in Massachusetts.[134] During the trial, the trial judge granted motions *in limine* prohibiting any introduction into evidence of the existence of the prayer exemption to the child neglect statute.[135] The defense had argued that the existence of this exemption was relevant to determining what a reasonable parent would do when a child exhibited the symptoms that Robyn Twitchell did.[136] Indeed, as one of the jurors in the trial has indicated in an article reflecting on her experience, the introduction of such evidence could have proven pivotal:

> The jury was often asked, in the wording of the charge, to hold the Twitchells' actions to those of a "reasonable" person. It seems to me that the Twitchells could have reasonably interpreted the exemption law, as well as the attorney

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[131] *Id.*
[132] *Id.*
[133] *Id.* at 782.
[134] On October 6, 1992, Judge Sandra Hamlin denied the Twitchells' motion for a new trial based on her jury charge and her failure to admit certain evidence. Doris Sue Wong, *Christian Scientists Ask SJC to Hear Appeal*, BOSTON GLOBE, Oct. 23, 1992, at 25. On October 22, 1992, the Twitchells petitioned the Supreme Judicial Court of Massachusetts for a direct appeal of their case. Doris Sue Wong, *New Trial Denied for Christian Science Couple*, UPI, Oct. 23, 1992, *available in* LEXIS, Nexis Library, Omni File.
[135] Umin interview, *supra* note 13.
[136] *Id.*

> general's opinion, as protecting their choice of spiritual healing over medical care.[137]

The forewoman of the jury was so outraged by the judge's exclusion of the evidence that she wrote a letter to Chief Judge Robert Steadman of the Superior Court accusing trial judge Sandra Hamlin of bias and manipulation of the verdict.[138]

The Attorney General's opinion to which the juror refers is a 1975 opinion in which the Attorney General stated that the exemption "expressly precludes imposition of criminal liability as a negligent parent for failure to provide medical care because of religious beliefs."[139] Though obtuse, the opinion does state clearly that the exemption precludes criminal liability for child neglect. This conclusion is not clear from the statute itself, however. The statute simply states that "[a] child shall not be deemed to be neglected or lack proper physical care for the sole reason that he is being provided remedial treatment by spiritual means alone."[140] The statute thus states merely that treating a child by spiritual means is not *itself* a factor in determining neglect. The Attorney General's opinion takes the exemption at least a step further by stating that it precludes criminal liability for neglect altogether.

What is unclear is whether one can understand the Attorney General's opinion as making the more expansive claim that the prospect of any criminal liability, arising out of acts that otherwise would constitute neglect, is eliminated by the spiritual-treatment exemption. In any event, it is the perception and not the intention that matters here; even if the Attorney General did not intend to go so far, the opinion is sufficiently ambiguous that a Christian Scientist consulting it could be misled. However, in states employing the "solely" language that do not have similar interpretative statements, the meaning of "solely" is unclear. This creates a weaker due process argument if a court interprets the statutory language strictly. Bolstering a due process argument in *Twitchell* is the fact that from the time Massachusetts passed its spiritual exemption in 1971 until the

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[137] Chris Dickinson, *View from the Jury Box*, BOSTON PHOENIX, Sept. 7, 1990, § 2, at 4.

[138] *Juror Alleges Bias in Boston Case*, WASH. POST, Aug. 11, 1990, at A6. Judge Steadman decided not to take action on the letter and referred it to Judge Hamlin for her consideration. Doris Sue Wong, *Juror's Claim of Biased Judge Spurs No Action*, BOSTON GLOBE, Aug. 11, 1990, at 29.

[139] 59 Op. Mass. Att'y Gen. 2 (1975).

[140] MASS. GEN. L. ch. 273, § 1 (1991).

Twitchell case, no Christian Scientist parents had been prosecuted in connection with treatment of their children through spiritual means.[141]

C. *The Religion Clauses and the Prayer-Treatment Exemption Cases*

As noted in the introduction, the Free Exercise Clause and the Establishment Clause color the due process analyses of the prayer-exemption statutes' intersection with manslaughter statutes. In addition to the due process challenges, the defendants in *Walker* and *Hermanson* raised free exercise challenges to the statutes.[142] Furthermore, courts and commentators have raised questions about whether the exemptions violate the Establishment Clause.

1. Free Exercise of Religion

The Supreme Court's decision in *Employment Division, Department of Human Resources v. Smith*[143] put to rest the question of whether Christian Scientist defendants successfully could raise a direct challenge to manslaughter prosecution under the Free Exercise Clause.[144] Even prior to *Smith,* it was highly doubtful that such a challenge would succeed.

Smith fundamentally changed free exercise jurisprudence and made the prospect of a free exercise challenge to criminal child abuse, neglect, and general manslaughter laws implausible.[145] In *Smith,* the respondents were dismissed from employment as drug counselors for using the drug peyote. They brought a free

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[141] Catherine Arnst, *Christian Scientists Charged with Manslaughter in Son's Death,* The Reuter Library Report, Apr. 27, 1988, *available in* LEXIS, Nexis Library, Omni File.

[142] Walker v. Superior Court, 763 P.2d 852, 869–71 (Cal. 1988), *cert. denied,* 491 U.S. at 905 (1989); Hermanson v. State, 570 So. 2d 322, 333–35 (Fla. Dist. Ct. App. 1990), *rev'd,* 604 So. 2d 775 (Fla. 1992).

[143] 494 U.S. 872 (1990).

[144] *But see* Edward E. Smith, *The Criminalization of Belief: When Free Exercise Isn't,* 42 HASTINGS L.J. 1491 (1991) (arguing that a criminal prosecution of Christian Scientist parents would violate the Free Exercise Clause while state intervention would not).

[145] *See* Michael M. McConnell, *Free Exercise Revisionism and the Smith Decision,* 57 U. CHI. L. REV. 1109 (1990); *see also* William P. Marshall, *Correspondence on Free Exercise Revisionism: In Defense of Smith and Free Exercise Revisionism,* 58 U. CHI. L. REV. 308 (1991) (agreeing with McConnell that the Court in *Smith* altered free exercise jurisprudence while claiming it was not doing so, but arguing that this revised jurispru-

exercise challenge against a ruling that their dismissal was due to misconduct and that they were thus ineligible for unemployment benefits. Respondents, members of the Native American church, maintained that they had used the drug in conjunction with a religious ceremony. The Court held that "the right of free exercise does not relieve an individual of the obligation to comply with a 'valid and neutral law of general applicability on the ground that the law proscribes (or prescribes) conduct that his religion prescribes (or proscribes).'"[146] This ruling that the Constitution provides no exemption from generally applicable laws, with no requirement that the state show a compelling interest or engage in any sort of balancing, has inspired harsh criticism from commentators, who see it as a departure from precedent.[147]

The Court noted in *Smith* that penal statutes are particularly immune from any sort of balancing of free exercise rights against the government's avowed interest in adopting the penal statute.[148] Dicta in *Smith* also suggests the implausibility of a free exercise challenge to the prosecution of parents who use spiritual means to treat their children. Justice Scalia wrote that the balancing test advanced by the respondents "would open the prospect of constitutionally required religious exemptions from civic obligations of almost every conceivable kind [including] health and safety regulations such as manslaughter and child

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[146] *Smith*, 494 U.S. at 879 (quoting United States v. Lee, 455 U.S. 252, 263 n.3 (1982) (Stevens, J., concurring) (rejecting claim of Old Order Amish employer that compulsory Social Security tax violated his right to free exercise of religion in light of the religious obligation of the Amish to care for the elderly themselves)).

[147] *See, e.g.*, Douglas Laycock, *The Remnants of Free Exercise*, 1990 SUP. CT. REV. 1, 2–3 (calling Justice Scalia's discussion of precedent "transparently dishonest"); McConnell, *supra* note 145. McConnell was outraged at the Court's statement that it had "never held that an individual's religious beliefs excuse him from compliance with an otherwise valid law prohibiting conduct that the State is free to regulate," in light of the Supreme Court precedents doing just that. *See id.* at 1120. In Sherbert v. Verner, 374 U.S. 398 (1963), for example, the Court required the government to show a compelling interest in order to place a substantial burden on religious practices. In *Smith*, Justice Scalia distinguished *Sherbert* and its progeny by arguing that these cases were limited to the context of unemployment benefits. *Smith*, 494 U.S. at 881; *see also* McConnell, *supra* note 145, at 1122 n.56. Justice Scalia also distinguished Wisconsin v. Yoder, 406 U.S. 205 (1972), in which the Court held that requiring Amish parents to send their children to school beyond the eighth grade violated the Free Exercise Clause. Justice Scalia wrote that *Yoder* involved religious activity in conjunction with another right, the right of parents to direct the education and upbringing of their children. *Smith*, 494 U.S. at 883; *see also* McConnell, *supra* note 145, at 1121–22. Professor Marshall agreed that the Court's distinguishing of *Yoder* "is particularly illustrative of poetic license." Marshall, *supra* note 145, at 309.

[148] "Even if we were inclined to breathe into *Sherbert* some life beyond the unemployment compensation field, we would not apply it to require exemptions from a generally applicable criminal law." *Smith*, 494 U.S. at 884.

neglect laws, . . . compulsory vaccination laws, . . . drug laws, . . . and traffic laws."[149]

Even prior to *Smith*, however, a free exercise challenge to a manslaughter prosecution of parents seemed highly unlikely to succeed.[150] In *Prince v. Massachusetts*,[151] the Supreme Court ruled that a Jehovah's Witness who had enlisted the assistance of her children and niece in selling a religious publication on the street was not exempted from child labor laws by the Free Exercise Clause. The Court explained that "[p]arents may be free to become martyrs themselves. But it does not follow they are free, in identical circumstances, to make martyrs of their children . . . ."[152]

Similarly, though the *Yoder* Court held that the state could not require Amish parents to send their children to high school, it observed that the state still could intervene when a parent's decision "will jeopardize the health or safety of the child, or have a potential for significant social burdens."[153] All of the recent state court cases addressing the issue, most of which were decided before *Smith*, have held that the Free Exercise Clause provides no protection to parents who treat their ill children with prayer.[154]

2. The Establishment Clause

In several of the prayer-treatment cases, the question has arisen whether the prayer-exemption statutes constitute an im-

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[149] *Id.* at 889.

[150] *See* Gathings, *supra* note 34, at 602–08; Schneiderer, *supra* note 26, at 1439–41. *But see* John D. Ingram, *State Interference with Religiously Motivated Decisions on Medical Treatment*, 93 DICK. L. REV. 41, 58–64 (1988); Clark, *supra* note 26, at 579–81 (arguing that *Yoder* requires the state to employ the least restrictive alternative to achieve its goal, and that prosecuting parents is not the least restrictive alternative since the state may require parents to report illnesses to the state and intervene when necessary to protect the child).

[151] 321 U.S. 158 (1944).

[152] *Id.* at 170.

[153] Wisconsin v. Yoder, 406 U.S. 205, 234 (1972).

[154] *Walker*, 763 P.2d at 869; *Hermanson*, 570 So. 2d 322, 331–32; State v. Miskimens, 490 N.E.2d 931, 934 (Ohio Ct. C. P. 1984) (holding a prayer-treatment exemption to a child endangerment statute unconstitutional); Commonwealth v. Barnhart, 497 A.2d 616, 622–25 (Pa. Super. Ct.) (upholding involuntary manslaughter and child endangerment convictions), *appeal denied*, 538 A.2d 874 (1985), *cert. denied*, 488 U.S. 817 (1988). Two other recent cases upheld the convictions of parents whose children died after being treated with prayer, but did not address the free exercise issue. Funkhouser v. State, 763 P.2d 695 (Okla. Crim. App. 1988) (upholding second-degree manslaughter conviction of parents whose infant died of pneumonia when treated solely through prayer), *cert. denied*, 490 U.S. 1066 (1989); Hall v. State, 493 N.E.2d 433 (Ind. 1986) (affirming reckless homicide conviction of parents whose son died after they treated his illness exclusively with prayer).

permissible establishment of religion by the government. One intermediate Ohio court ruled that the state's prayer exemption violated the Establishment Clause.[155] The Supreme Court of Delaware, in dicta, expressed some reservations about whether the state's prayer exemption, which requires that the parents use spiritual treatment by "a recognized church," and by a "duly accredited practitioner thereof" could withstand Establishment Clause scrutiny.[156] Many of the statutes in other states use similar language,[157] or even mention Christian Scientists by name.[158]

Exempting prayer treatment itself is not likely to be found to violate the Establishment Clause. The Supreme Court is increasingly willing to permit the government to accommodate the exercise of religion on the theory that the accommodation permitted by the Establishment Clause is broader than that which is compelled by the Free Exercise Clause.[159] At the end of the *Smith* opinion, Justice Scalia intimated that the Court's diminution of an individual's ability to claim a religious exemption to a law of general applicability under the Free Exercise Clause might be balanced by higher tolerance of statutory exemptions to general laws. Justice Scalia wrote that "a society that believes in the negative protection accorded to religious belief [in the Bill of Rights] can be expected to be solicitous of that value in its legislation."[160]

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[155] *Miskimens*, 490 N.E.2d at 934.

[156] Newmark v. Williams, 588 A.2d 1108, 1114 (Del. 1991) (noting that the issue was not raised by either party and thus the court "must leave such questions to another day").

[157] *See* statutes cited *supra* note 47.

[158] *See* statutes cited *supra* note 46.

[159] *See* Corporation of the Presiding Bishop of the Church of Jesus Christ of Latter Day Saints v. Amos, 483 U.S. 327 (1987) (holding that provision in Title VII of the Civil Rights Act of 1964, permitting religious organizations to discriminate based on religion in hiring practices, does not violate Establishment Clause, even in case where job was in church-owned health club open to the public); Witters v. Washington Dep't of Servs. for the Blind, 474 U.S. 481 (1986) (holding that state did not violate Establishment Clause by giving vocational rehabilitation funds to blind man who used the funds for religious training, since the choice to use the funds for this purpose was made by the student); Lynch v. Donnelly, 465 U.S. 668, 673 (1984) (finding no Establishment Clause violation by town erecting creche as part of holiday display, stating that the Constitution does not "require complete separation of church and state; it affirmatively mandates accommodation, not merely tolerance, of all religions, and forbids hostility toward any"); Michael M. McConnell, *Accommodation of Religion*, 1985 SUP. CT. REV. 1; Michael A. Paulsen, *Religion, Equality and the Constitution: An Equal Protection Approach to Establishment Clause Adjudication*, 61 NOTRE DAME L. REV. 311 (1986); Mark Tushnet, *The Emerging Principle of Accommodation of Religion (Dubitante)*, 76 GEO. L.J. 1691 (1988).

[160] *Smith*, 494 U.S. at 890.

The Establishment Clause problem that might be posed by the prayer exemptions arises from the language the statutes use to define qualification for an exemption. As noted earlier, several statutes provide exemptions only to Christian Scientists,[161] or exempt only those parents who use an accredited prayer practitioner,[162] which has the effect of limiting the exemption to Christian Scientists. The Court has held that it will apply strict scrutiny to statutes that have the effect of granting a denominational preference.[163] It is not clear how much bite this strict scrutiny has, in light of precedents upholding statutes that discriminate among sects, either explicitly or in effect.[164] It is worth noting, however, that Justice Scalia, in his invitation to legislatures to fashion religious exemptions, was careful to state that only "nondiscriminatory religious-practice exemption[s]" are permitted.[165]

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[161] *See* statutes cited *supra* note 46.

[162] *See* statutes cited *supra* note 47.

[163] Larson v. Valente, 456 U.S. 228, 246 (1981) (striking down state charitable solicitation statute that classified a religion as "charitable" only if it received more than half of its funds from members).

[164] *See* Hernandez v. Commissioner, 490 U.S. 680 (1989) (upholding an I.R.S. ruling that disallowed the deduction of payments claimed as charitable contributions by Church of Scientology members). The Court found that payments to the church for one-on-one spiritual "auditing" and "training" services were a quid pro quo for services. Justices O'Connor and Scalia dissented, comparing the quid pro quo here to the Protestant practice of pew rental fees or the Jewish practice of selling tickets to High Holy Day services. *Id.* at 709 (O'Connor, J., dissenting); *see also* Gillette v. United States, 401 U.S. 437 (1971) (finding no Establishment Clause violation in conscientious objector statute that exempted those who oppose all war for religious reasons, but did not exempt Roman Catholics, whose church distinguishes between just and unjust wars); Rupert v. Director, United States Fish & Wildlife Serv., 957 F.2d 32 (1st Cir. 1992) (holding that statute that exempts only Native Americans who use eagle feathers for religious purposes from federal criminal statute prohibiting the possession of eagle feathers meets strict scrutiny); Peyote Way Church of God, Inc. v. Thornburgh, 922 F.2d 1210 (5th Cir. 1991) (upholding exemption for Native American Church of North America from federal and Texas narcotics laws concerning peyote use); Olsen v. Drug Enforcement Admin., 878 F.2d 1458 (D.C. Cir. 1989) (upholding federal peyote exemption but refusing to extend it to protect member of church that engages in the religious use of marijuana).

[165] *Smith*, 494 U.S. at 890. See also Justice Scalia's concurrence in Cruzan v. Director, Missouri Dep't of Health, 497 U.S. 261 (1990), in which, after arguing that the Constitution "has nothing to say" about the right of an individual to reject medical treatment, he added that "[o]ur salvation is the Equal Protection Clause, which requires the democratic majority to accept for themselves and their loved ones what they impose on you and me." (The connection between Justice Scalia's *Cruzan* concurrence and religious exemptions was suggested by Professor Frank Michelman of Harvard Law School at a conference entitled *The Weakening Wall? Current Issues in the Separation of Religion and State*, April 5, 1992, Austin Hall, Harvard Law School). In light of Justice Scalia's *Cruzan* concurrence, and considering the declaration in *Olsen* that the "establishment clause and equal protection analyses converge" in cases involving laws that discriminate among religious sects, *Olsen*, 878 F.2d at 1463 n.5, it seems that the Court, or at least Justice Scalia, may be increasingly vigilant to ensure that exemption laws passed to accommodate religion do not discriminate among denominations.

The Court has not been hesitant to examine an individual's belief to determine matters of sincerity and religiosity. For example, in cases involving statutes exempting conscientious objectors from military service, the Court readily has inquired whether persons claiming the exemption sincerely believed in a "Supreme Being."[166] In light of these precedents, exemptions for spiritual treatment defined as the "legitimate" or "good faith" practice of religion should not pose Establishment Clause problems.

On the other hand, the statutes that require that prayer treatment conform to the tenets of a recognized church pose potential entanglement problems. The Establishment Clause greatly restricts the courts' freedom to delve into religious doctrine.[167] In attempting to understand a religion such as Christian Science, which conceives of reality and matter in a radically different manner from Newtonian science and the world with which jurors and judges are familiar,[168] it is difficult to determine in objective terms whether the tenets set forth by the Church are being followed.

Professor Tribe has argued that an entanglement problem arises in the *Walker* court's construction. In his certiorari petition, Professor Tribe argued that the court's denial of a spiritual-treatment defense to manslaughter, coupled with the retention of such a defense for child abuse and neglect, forces a jury to determine the point at which a reasonable parent using spiritual means to treat a child should abandon spiritual efforts and seek medical attention.[169] According to Professor Tribe, this determination violates the Establishment Clause by requiring the trier of fact to evaluate the validity of spiritual treatment by deciding that it is efficacious for one degree of illness but potentially life threatening for another.[170] Professor Tribe's concerns may be misplaced, however. A *parent* with an ill child is faced with the problem of evaluating his or her own confidence in spiritual healing for severe illnesses as well as for minor ones. However,

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[166] *Gillette*, 401 U.S. 437; Welsh v. United States, 398 U.S. 333 (1970); United States v. Seeger, 380 U.S. 163 (1965).

[167] Jones v. Wolf, 443 U.S. 595 (1979); Presbyterian Church in the United States v. Mary Elizabeth Blue Hull Memorial Presbyterian Church, 393 U.S. 440 (1969); *see also* LAURENCE H. TRIBE, AMERICAN CONSTITUTIONAL LAW § 14-11, at 1226–42 (1988).

[168] *See* MARY BAKER EDDY, SCIENCE AND HEALTH WITH KEY TO THE SCRIPTURES (1875).

[169] Tribe Petition, *supra* note 72, at 19–22.

[170] *Id.*

from the standpoint of the judge or jury, there is no such problem. If the illness was minor and no permanent harm befell the child, the exemption for child neglect applies and the case does not get to the trier of fact. If harm or death results, the judge or jury merely evaluates whether any reasonable parent would have treated a child with such symptoms with medical care, disregarding the efficacy of spiritual treatment.[171] While this may be unfair to the parent as a question of notice and due process, it does not create an Establishment Clause problem. Similarly, Establishment Clause problems have not surfaced regarding Oklahoma's prayer-treatment exemption, which withdraws the exemption in cases where serious bodily harm could result.[172] A jury evaluating an Oklahoma parent's spiritual treatment could avoid entanglement problems by inquiring whether a reasonable parent would recognize that a child might suffer harm and whether a reasonable parent would have taken the child to a doctor. Again, while this may place burdens on a parent that may be deemed unfair as question of public policy, or may require an inquiry into due process, it does not run afoul of the Establishment Clause.

II. Vagueness

The vagueness doctrine is the well-established, over-arching doctrine that encompasses many of the due process issues that have arisen in prayer-exemption cases: fair notice, defendants' reliance on narrow statutory language, and contradictory commands in statutes. Furthermore, the underlying rationales of the vagueness doctrine also encompass the *Raley/Cox* doctrine, which allows a defense of reliance on the government for interpretation of the law, and bars unintentional misleading by the government.

A. *Vagueness Review Generally*

The vagueness doctrine is based on the simple notion that the law must be understandable, both to provide sufficient notice

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[171] *See* Response in Opposition to Petition for Writ of Certiorari at 8, Walker v. Superior Court, 763 P.2d 852 (Cal. 1988), *petition for cert. filed*, 57 U.S.L.W. 3622 (U.S. Mar. 21, 1989) (No. 88-1471).

[172] OKLA. STAT. tit. 21 § 852(A) (1991).

to citizens to allow them to conform their conduct to the law and to provide coherent standards for the government to apply. In *Connally v. General Construction Co.*,[173] the Supreme Court described the first part of this doctrine, notice to the citizenry:

> That the terms of a penal statute creating a new offense must be sufficiently explicit to inform those who are subject to it what conduct on their part will render them liable to its penalties, is a well-recognized requirement, consonant alike with ordinary notions of fair play and the settled rules of law. And a statute which either forbids or requires the doing of an act in terms so vague that men of common intelligence must necessarily guess at its meaning and differ as to its application, violates the first essential of due process of law.[174]

Similarly, and more recently, the Court noted in *Grayned v. City of Rockford*[175] that "because we assume that man is free to steer between lawful and unlawful conduct, we insist that laws give the person of ordinary intelligence a reasonable opportunity to know what is prohibited, so that he may act accordingly. Vague laws may trap the innocent by not providing fair warning."[176] The *Grayned* Court also stated the second rationale for requiring statutory clarity: "[L]aws must provide explicit standards for those who apply them."[177] Clarity in the laws is basic to the rule of law and appeals to our sense of fairness. Lon Fuller included this concept as one of the eight desiderata of a system of law in his classic work *The Morality of Law*, calling clarity "one of the most essential ingredients of legality."[178] A regime that punishes without giving an opportunity to the governed to know

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[173] 269 U.S. 385 (1926).

[174] *Id.* at 391.

[175] 408 U.S. 104 (1972).

[176] *Id.* at 108; *see also* Kolender v. Lawson, 461 U.S. 352, 357–58 (1982); Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489, 498 (1982); Papachristou v. City of Jacksonville, 405 U.S. 156, 162 (1972); Lanzetta v. New Jersey, 306 U.S. 451, 453 (1939); McBoyle v. United States, 283 U.S. 25, 27 (1931); Cline v. Frink Dairy Co., 274 U.S. 445, 457–60 (1927); *Connally*, 269 U.S. at 391; United States v. L. Cohen Grocery, 255 U.S. 81, 89–92 (1921); International Harvester Co. v. Kentucky, 234 U.S. 216, 223–24 (1914).

[177] *Grayned*, 408 U.S. at 108; *see also Kolender*, 461 U.S. at 357–58; *Flipside*, 455 U.S. at 498; *Papachristou*, 405 U.S. at 162; Shuttlesworth v. City of Birmingham, 382 U.S. 87, 90–91 (1965); Thornhill v. Alabama, 310 U.S. 88, 97–98 (1940). In *Kolender*, which involved the invalidation of a loitering law on vagueness grounds, the Court noted that the notice prong of the doctrine is less important than the arbitrary enforcement prong. 461 U.S. at 358. This observation in *Kolender* suggests that the nature of the vagueness doctrine varies according to the type of law at issue. With a loitering law, as in *Kolender*, the Court sees arbitrary enforcement as the most evident danger.

[178] LON L. FULLER, THE MORALITY OF LAW 63 (1964).

what behavior is expected of them is tyranny. Justice Douglas once compared a vague law to the Roman Emperor Caligula's "practice of printing the laws in small print and placing them so high on a wall that the ordinary man did not receive fair warning."[179]

The vagueness doctrine, applied to criminal laws, relates closely to two other principles governing the relationship between courts and legislatures: the principle of legality and the principle of lenity.[180] These three doctrines are in fact elements of the same triune principle of "judicial incompetence in the formulation of substantive criminal law."[181] The principle of legality, or *nulla poena sine lege*, prohibits the common law practice of the judicial creation of crimes.[182] The principle extends both to the abolition of common law crimes and to the due process requirement that a court may not expand statutory language in a way as that deprives defendants of fair notice that their conduct is criminal.[183] The principle of legality is thus closely tied to the prohibition against *ex post facto* laws in Article I of the Constitution.[184] *Ex post facto* laws run counter to the very concept of the rule of law. At the constitutional convention, Oliver Ellsworth opposed including a provision against *ex post facto* laws in the Constitution, arguing that the principle was inherently obvious and therefore did not need enumeration: "[T]here [is] no lawyer, no civilian, who would not say that ex post facto laws were void in themselves."[185]

The principle of lenity is based on the notion that uncertainties are to be resolved in favor of the defendant when a criminal statute is unclear.[186] Although lenity is a doctrine of statutory construction rather than a constitutional principle, courts describing it use language evoking the due process tones of vague-

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[179] Huddleston v. United States, 415 U.S. 814, 834 (1974) (Douglas, J., dissenting).

[180] *See* John Calvin Jeffries, Jr., *Legality, Vagueness, and the Construction of Penal Statutes*, 71 VA. L. REV. 189 (1985).

[181] *Id.* at 189.

[182] *Id.*

[183] *See* Bouie v. City of Columbia, 378 U.S. 347 (1964).

[184] U.S. CONST. art. I, § 8.

[185] 2 MAX FERRAND, THE RECORDS OF THE FEDERAL CONVENTION OF 1787, at 376 (1966), *quoted in* HADLEY ARKES, BEYOND THE CONSTITUTION 27 (1990).

[186] *See* United States v. Kozminski, 487 U.S. 931, 952 (1988) ("[W]e adhere to the time-honored interpretive guideline that uncertainty concerning the ambit of criminal statutes should be resolved in favor of lenity."); United States v. U.S. Gypsum Co., 438 U.S. 422, 437 (1978); Rewis v. United States, 401 U.S. 808, 812 (1971); Jeffries, *supra* note 180, at 198–201.

ness and legality analysis. As the Court described it in *Huddleston*:

> This rule of narrow construction is rooted in the concern of the law for individual rights, and in the belief that fair warning should be accorded as to what conduct is criminal and punishable by deprivation of liberty and property . . . . The rule is also the product of an awareness that legislators and not the courts should define criminal activity.[187]

Despite the powerful language used by courts in describing lenity, the rule today is not used with sufficient frequency or consistency to constitute a true doctrine. As Professor Jeffries writes, "[t]oday, strict construction survives more as a makeweight for results that seem right on other grounds than as a consistent policy of statutory interpretation."[188]

In *McKown*, the Minnesota Court of Appeals included a section on lenity at the end of its discussion of the due process grounds for barring a manslaughter prosecution against the McKowns. Interestingly, this discussion of lenity came at the end of the due process section, not in the section on statutory construction of the child neglect and manslaughter statutes, where the court held that the prayer exemption of the former did not apply to the latter. The court wrote that "[w]e turn next to a related doctrine of criminal law, one not specifically grounded in the fourteenth amendment, but one which we believe buttresses and supports the due process argument."[189] The court quoted the Supreme Court's statement in *Liparota v. United States*[190] that "[a]pplication of the rule of lenity ensures that criminal statutes will provide fair warning concerning conduct rendered illegal and strikes the appropriate balance between the legislature, the prosecutor, and the court in defining criminal liability."[191] The *McKown* court found that the legislative history was "at best, ambiguous, and at worst, utterly contradictory," and therefore the rule of lenity required barring the prosecution.[192]

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[187] Huddleston v. United States, 415 U.S. 814, 831 (1974). The Court, however, found that the statute "clearly proscribes petitioner's conduct and accorded him fair warning of the sanctions the law placed on that conduct." *Id.*

[188] Jeffries, *supra* note 180, at 198–99.

[189] State v. McKown, 461 N.W.2d 720, 725 (Minn. Ct. App. 1990), *rev'd*, 475 N.W.2d 63 (Minn. 1991), *cert. denied*, 112 S. Ct. 882 (1992).

[190] 471 U.S. 419 (1985).

[191] *Id.* at 427.

[192] *McKown*, 461 N.W.2d at 725.

Many commentators have noted that the concept of notice, found in doctrines such as vagueness, the rule of law, and lenity, is somewhat of a myth. Most people are not aware of the law regardless of its clarity or lack thereof.[193] As John Chipman Gray stated, "practically, in its application to actual affairs, for most of the laity, the Law . . . is all *ex post facto*."[194] Despite this, the Supreme Court has consistently cited and discussed the notice rationale in its vagueness, lenity, and legality decisions. The Court often admits the fact that notice can become irrelevant in practice. For example, in *McBoyle v. United States*,[195] Justice Holmes wrote that "[a]lthough it is not likely that a criminal will carefully consider the text of the law before he murders or steals, it is reasonable that a fair warning should be given to the world in language that the common world will understand, of what the law intends to do if a certain line is passed."[196] Thus, while courts acknowledge the fictitious quality of the common law rule that all men are presumed to know the law,[197] they require that the law be clear, so that those who do in fact consult it are not confused or misled. The issue of notice becomes more relevant in instances such as the prayer-exemption cases, where there is evidence that Christian Scientists do in fact consult the law.[198]

A court's vagueness analysis is heightened when First Amendment values are involved. As Professor Amsterdam argued in *The Void-For-Vagueness Doctrine in the Supreme Court*,[199] the most frequently cited work on the vagueness doctrine,[200] the primary focus of the vagueness doctrine is to serve underlying values. In the first third of this century, laws struck

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[193] *See, e.g.*, Jeffries, *supra* note 180, at 205–13; Anthony G. Amsterdam, Note, *The Void-For-Vagueness Docrine in the Supreme Court*, 109 U. PA. L. REV. 67, 82 n.79 (1960).

[194] JOHN CHIPMAN GRAY, THE NATURE AND SOURCES OF LAW 100 (1921).

[195] 283 U.S. 25 (1931).

[196] *Id.* at 27; *see also* Smith v. Goguen, 415 U.S. 566, 574 (1974) ("We recognize that in a noncommercial context behavior as a general rule is not mapped out in advance on the basis of statutory language.").

[197] *See infra* part III.A.

[198] *See supra* note 114.

[199] *Supra* note 193. Anthony Amsterdam is now Professor of Law at New York University.

[200] *See* Jeffries, *supra* note 180, at 196 n.19. Many Supreme Court cases on vagueness cite Professor Amsterdam's note. *See, e.g.*, Vance v. Universal Amusement Co., 445 U.S. 308, 315 n.12 (1980); Shuttlesworth v. City of Birmingham, 382 U.S. 87, 90 n.5 (1965).

down for vagueness tended to impinge on economic rights, reflecting that era's concern for such rights.[201] Since then, the vagueness doctrine has almost always involved First Amendment issues.[202] As a result, Professor Amsterdam subtitled his Note "A Means to an End," arguing that the subsidiary values served by the vagueness doctrine are in fact its driving force.

Other commentators have downplayed the subsidiary value argument, but still emphasize that cases involving such values will receive heightened vagueness scrutiny. Professor Tribe notes that "a vague law need not reach activity protected by the first amendment."[203] However, he argues that because vague laws may potentially chill constitutionally protected activity such as speech, "the Supreme Court requires more specificity of a statute potentially applicable to expression sheltered by the first amendment than in other contexts, although no doctrinal formulation of the required increment in specificity has seemed possible."[204]

In fact, the Court has struck down a wide variety of penal statutes that do not involve speech or other constitutionally protected rights.[205] Justice Scalia, joined by three other justices, has remarked that the pattern requirement in the Racketeer Influenced and Corrupt Organization Act ("RICO")[206] should be struck down on vagueness grounds.[207] However, concern for

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[201] Amsterdam, *supra* note 193, at 85 n.87.

[202] *Id.* at 85 n.88.

[203] TRIBE, *supra* note 167, at 1033.

[204] *Id.* at 1034; *see also* Jeffries, *supra* note 180, at 195 (stating that "a paramount concern is whether the law's uncertain reach implicates protected freedoms," but noting numerous other factors that go into a court's reasoning).

[205] *See, e.g.*, Kolender v. Lawson, 461 U.S. 352 (1983) (loitering law); Papachristou v. City of Jacksonville, 405 U.S. 156 (1972) (vagrancy ordinance); Giaccio v. Pennsylvania, 382 U.S. 399 (1966) (law authorizing jury to assess costs against criminal defendants—arguably a civil statute rather than a penal statute); Shuttlesworth v. City of Birmingham, 382 U.S. 87 (1965) (loitering law); Bouie v. City of Columbia, 378 U.S. 347 (1964) (trespassing statute); Lanzetta v. New Jersey, 306 U.S. 451 (1939) (statute making it criminal to be a member of a "gang"); McBoyle v. United States, 283 U.S. 25 (1931) (statute barring interstate transport of motor vehicle).

[206] 18 U.S.C. §§ 1961–1968 (1988), *amended by* 18 U.S.C. §§ 1961–1968 (Supp. II 1990).

[207] H.J. Inc. v. Northwestern Bell Tel., 492 U.S. 229, 255–56 (1989) (Scalia, J., concurring); *see also* Lisa Barsoomian, Comment, *RICO "Pattern" Before and After H.J. Inc.: A Proposed Definition*, 40 AM. U. L. REV. 919 (1991); Joseph E. Bauerschmidt, Note, *"Mother of Mercy—Is This the End of RICO?": Justice Scalia Invites Constitutional Void-For-Vagueness Challenge to RICO "Pattern"*, 65 NOTRE DAME L. REV. 1106 (1990); David W. Gartenstein & Joseph F. Warganz, Note, *RICO's "Pattern" Requirement: Void for Vagueness?*, 90 COLUM. L. REV. 489 (1990).

underlying values, such as speech,[208] or recently the right to abortion,[209] remains prominent.[210]

In addition to displaying heightened sensitivity to underlying values and freedoms, the Court recently outlined a number of other areas in which a vagueness challenge is more likely to succeed.[211] Economic regulation is less susceptible to a vagueness attack than other legislation, since business people are likely to analyze carefully relevant legislation and attempt to resolve ambiguities.[212] Criminal statutes are more likely to be struck down than civil statutes.[213] Laws lacking a scienter requirement are subject to closer scrutiny.[214] In addition, the Court has been more willing to find a statute void for vagueness if it punishes acts of omission rather than positive acts.[215]

The prayer-exemption cases seem to meet the Supreme Court's standards for heightened scrutiny. Although spiritual treatment is not an activity protected by the Free Exercise

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[208] *See, e.g.*, Smith v. Goguen, 415 U.S. 566, 568–69 (1974) (finding unconstitutionally vague a law making it criminal to "treat[ ] contemptuously the flag of the United States").

[209] *See* City of Akron v. Akron Ctr. for Reprod. Health, Inc., 462 U.S. 416, 451–52 (1983) (holding that law requiring disposal of fetal remains in "humane and sanitary" way was unconstitutionally vague); Colautti v. Franklin, 439 U.S. 379, 390–401 (1979) (holding that viability test requirement and standard-of-care requirement were impermissibly vague); Margaret S. v. Edwards, 794 F.2d 994, 998–99 (5th Cir. 1986) (finding unconstitutionally vague a law making it illegal to "experiment" on unborn children or children born as a result of an abortion unless "therapeutic" to the child). *But see* Planned Parenthood v. Minnesota, 910 F.2d 479, 482–86 (1990) (finding fetal disposal law not unconstitutionally vague); Planned Parenthood v. Arizona, 718 F.2d 938, 946–49 (9th Cir. 1983) (holding that law prohibiting state money to be used for "counseling for abortion procedures" was not unconstitutionally vague).

[210] Particularly illustrative of the importance of the underlying substantive value is the Court's decision in Reproductive Health Service v. Webster, 492 U.S. 490 (1989) (upholding state law requiring fetal viability testing before an abortion, restricting the use of public facilities and employees for elective abortions, and restricting abortion counseling by public employees). The Court wrote that "[t]here is no doubt that our holding today will allow some governmental regulation of abortion that would have been prohibited under the language of cases such as [*Colautti*] and [*Akron*]." *Id.* at 520–21. *Webster* did not address the vagueness implications of the issues before it, but instead resolved them as a matter of substantive law. In dicta the Court indicated that by weakening the substantive right to an abortion in *Webster*, some laws that were previously considered overly vague might no longer be so considered.

[211] Village of Hoffman Estates v. Flipside, Hoffman Estates, Inc., 455 U.S. 489 (1982); *see also* Tribe Petition, *supra* note 72, at 9–10.

[212] *Flipside*, 455 U.S. at 498.

[213] *Id.* at 498–99.

[214] *Id.* at 499.

[215] *See* Kolender v. Lawson, 461 U.S. 352, 353 n.1 (1983) (holding impermissibly vague a law that made it criminal for a person to "refuse[ ] to identify himself and to account for his presence when requested by any peace officer so to do"); TRIBE, *supra* note 167, at 1033 n.3; *cf.* Lambert v. California, 355 U.S. 225, 228 (1957) ("[W]e deal here with conduct that is wholly passive—mere failure to register. It is unlike the commission of acts, or the failure to act under circumstances that should alert the doer to the consequences of his deed.").

Clause, laws affecting a parent's ability to engage in this activity at least touch upon an area that was seen as sufficiently prone to excessive infringement by the government to warrant inclusion in the First Amendment of the Bill of Rights. Second, a parent's treatment of his or her child's illnesses is far removed from the commercial realm: it is part of the everyday decisions that parents make in raising and caring for their children in the way they think best. Third, while the crime of manslaughter does have a scienter requirement, there is a lesser degree of moral condemnation involved in a case of this kind where there is such strong subjective good faith than in other crimes involving negligence or recklessness. Therefore, these cases are qualitatively different from other cases involving crimes with a scienter requirement, and seem closer to those without such a requirement. Finally, parents accused of manslaughter are being accused of committing an act of omission—failing to fulfill a positive duty—rather than committing a prohibited act.

Yet the vagueness doctrine, as conventionally applied, does not dispose of the prayer-exemption/manslaughter cases. While all of the criteria seem to be in place, including the lack of fair warning and all of the triggers for heightened scrutiny, the most fundamental requirement for vagueness review is missing: there is no vague law. There has been no suggestion that the manslaughter statutes themselves are vague, nor that the wording of the prayer exemptions are vague.[216] What has been alleged is that the statutes working together create confusion and lack of notice. There is extremely little case law dealing with two statutes with some degree of apparent conflict. Useful analogies can be drawn from cases involving conflicts within a single statute. The following section will attempt to explain the position of these cases in the broad contours of the vagueness doctrine.

B. *Contradictory Commands in Statutes*

The leading case on the due process problems with contradictory commands in statutes is *United States v. Cardiff*.[217] In

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[216] The exception is State v. Miskimens, 490 N.E.2d 931 (Ohio Ct. C.P. 1984), which found that the prayer exemption to the Ohio felony child endangerment statute was unconstitutionally vague, and therefore barred prosecution. The probable reason that the court found the statute vague rather than finding that the exemption simply barred prosecution (the exemption on its face purported to provide an absolute defense) was that it also found the prayer exemption to violate the Establishment Clause. *Id.* at 934.

[217] 344 U.S. 174 (1952).

Cardiff, the Supreme Court held that a federal food-inspection statute containing contradictory commands was void for vagueness. One section of the statute required inspectors to obtain permission from the owner before inspecting a factory.[218] A second section made it a misdemeanor to refuse entry to an inspector.[219] The court ruled that the statute was void for vagueness, since it did not give "fair warning to the factory manager that if he fails to give consent, he is a criminal," in light of the section requiring inspectors to obtain permission.[220]

Cardiff involved a single statute, but courts have also applied this principle to cases where the contradiction is between two statutes. In *Chalmers v. Los Angeles*,[221] the Ninth Circuit upheld an action under 42 U.S.C. § 1983 brought by a T-shirt vendor who had been prevented from selling her goods by police who threatened her with arrest under a city ordinance barring vending within a large area of the city. The basis of the claim was that the vendor had been denied her due process rights, since she had decided to sell her T-shirts in reliance on a second city ordinance that permitted vendors to sell from pushcarts if they stopped only at the request of customers and only for ten-minute periods. The court ruled that the two statutes, as applied to this vendor, were unconstitutionally vague, since they did not give her fair warning that her conduct was criminal.[222] There was evidence that the vendor had actual notice of the statutes. She had been given copies of the ordinance when she received her vendor's permit.[223] Furthermore, the defendant asked city employees about the inconsistency and was assured that she could follow the ten-minute rule.[224] The court held that the city council's "creation of conflicting and inherently unclear ordinances" failed to give fair warning to the defendant and thus violated her due process rights.[225] Similarly, in *State v. Hill*,[226] the Kansas Supreme Court ruled that a statute providing exceptions for goods "of immediate necessity" to a Sunday-closing statute barring sale of all goods was vague and therefore upheld the district

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[218] *Id.* at 174–75.
[219] *Id.* at 174.
[220] *Id.* at 176 (citations omitted).
[221] 762 F.2d 753 (9th Cir. 1985).
[222] *Id.* at 756–60.
[223] *Id.* at 758.
[224] *Id.*
[225] *Id.*
[226] 369 P.2d 365 (Kan. 1962).

court's finding that the Sunday-closing statute was "inoperative and void."[227]

More frequently, however, the lower court cases on contradictory commands are like *Cardiff* in that the cases involve contradictions within a single statute. In *People v. Monroe*,[228] the Supreme Court of Illinois struck down a state drug paraphernalia statute on vagueness grounds because it contained contradictory mental state requirements. The court found that the definitions section suggested a scienter requirement, while the liability section did not.[229] The court held that this ran afoul of the Due Process Clause, which "requires that a person of ordinary intelligence be given a reasonable opportunity to know what conduct is prohibited."[230] Similarly, in *Mid-Florida Coin Exchange, Inc. v. Griffin*,[231] the court ruled that a Florida statute regulating precious metal sales that stated in one section that "the records" of a purchase must be kept for three years, and in another that "the records" must be submitted to the local police within twenty-four hours of purchase, created a contradiction that was unconstitutionally vague.[232]

The issue of contradictory commands has received considerable attention in the area of contradictory sentencing provisions in penal statutes, although the due process argument in these cases is less compelling than that for contradictory statutes defining substantive offenses. In *United States v. Batchelder*,[233] the Supreme Court ruled that two separate gun control statutes with identical substantive elements but different punishments did not create a vagueness problem.[234] The Court noted that "vague sentencing provisions may pose constitutional questions if they do not state with sufficient clarity the consequences of

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[227] *Id.* at 367.

[228] 515 N.E.2d 42 (Ill. 1987).

[229] The definitions section of the statute defined paraphernalia as products "marketed for use" with illegal drugs. The court held that "marketed for use" connoted a volitional act by the defendant. *Id.* at 44. The liability section, however, made it criminal to sell paraphernalia if the defendant either knew or *should have known* that the items were paraphernalia, which does not require the actual knowledge that the "marketed for use" definition does. *Id.*

[230] *Id.* at 45.

[231] 529 F. Supp. 1006 (M.D. Fla. 1981).

[232] *Id.* at 1030.

[233] 442 U.S. 114 (1979).

[234] *But see* People v. Marcy, 628 P.2d 69, 74 (Colo. 1981) (noting that under Colorado constitution, "[i]n sharp contrast to *Batchelder* . . . equal protection of the laws requires that statutory classifications of crimes be based on differences that are real in fact and reasonably related to the general purposes of criminal legislation").

violating a given criminal statute."[235] However, the Court held that "[s]o long as overlapping criminal provisions clearly define the conduct prohibited and the punishment authorized, the notice requirements of the Due Process Clause are satisfied."[236] Hypothetically, at least, a convicted felon contemplating receiving a firearm in interstate commerce, and thus falling under the statutes, would be able to locate both statutes and recognize that either one could apply to the act he was contemplating.

Where actual contradiction exists among sentencing guidelines provided under multiple penal statutes which criminalize identical conduct, courts have found those statutes void for vagueness. In *Commonwealth v. Gagnon*,[237] the Massachusetts Supreme Judicial Court struck down as void for vagueness a statute under which those violating the statute would be sentenced to "not less than one year and not more than ten years, or by a fine," but in the very next sentence stated that "[a]ny person convicted of violating this subdivision shall be punished by a mandatory minimum one year term of imprisonment."[238]

In *United States v. Colon-Ortiz*,[239] the First Circuit ruled that the Anti-Drug Abuse Amendments Act of 1988,[240] which provided for a sentence, fine, or both, but added that no one sentenced under the statute may be placed on probation or have his sentence suspended, was "directly contradictory" and failed to give notice to the defendant that the statute required a mandatory jail sentence in light of the "or both" language.[241] However, the court found that the legislative history of the statute explicitly referred to the statute's imposition of mandatory sentences, and "the congressional intent is obvious by looking at relevant legislative history and accompanying statutory provisions."[242] Therefore, the court ruled that the "or both" language "was an inadvertent drafting error, and should be stricken from the statute."[243] The court refused to overturn the conviction of

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[235] *Batchelder*, 442 U.S. at 123.
[236] *Id.*
[237] 441 N.E.2d 753 (Mass.), *on reh'g*, 443 N.E.2d 407 (Mass. 1982), *cert. denied and appeal dismissed*, 461 U.S. 921, *and cert. denied*, 464 U.S. 815 (1983).
[238] MASS. GEN. L. ch. 94C, § 32(a) (1991). *But cf.* Commonwealth v. John Grant & Sons Co., 526 N.E.2d 768 (Mass. 1988) (holding that two statutes specifying different fines for violation of the same statutory offense were not fundamentally inconsistent).
[239] 866 F.2d 6 (1st Cir. 1989).
[240] 21 U.S.C. §§ 801–971 (1988), *as amended by* 21 U.S.C. §§ 801–971 (Supp. II 1990).
[241] *Colon-Ortiz*, 866 F.2d at 9.
[242] *Id.* at 10.
[243] *Id.*

the defendant, noting that the district court judge had stated that he "would not have chosen a fine anyway."[244]

However, another federal court found that this "or both" language used in the Anti-Drug Abuse Amendments Act of 1988 violated the due process requirement of notice.[245] The court expressed outrage at the First Circuit's striking of the "or both" language from the statute based on legislative history despite that court's finding that the language of the statute lacked the notice required under the Due Process Clause. The court noted sardonically that:

> This court had heretofore naively believed that only Congress could delete words from a federal statute. Furthermore, the First Circuit appears to believe that its deletion of the confusing words had a retroactive effect, curing the notice deficiency in regard to events which occurred before the court had even issued its opinion. Inexplicably, the copy of the United States Code which is located in this court's library still contains the words "or both" . . . .[246]

The court in *Preston* therefore held that the only constitutionally permissible application of the statute was to construe it to permit only a fine, thereby eliminating any notice problems.[247]

The contradictory command cases suggest a strong argument that prosecution of a parent for manslaughter creates due process problems when that parent relies on an exemption to a child neglect statute. The cases highlight the courts' view of statutes as guides to conduct, and illustrate that contradictions within them will lead to a court's holding a statute unconstitutional. Such contradictions are unconstitutional despite the existence of evidence outside the text of the statute, such as legislative history[248] or of the way in which statutes routinely were applied,[249] that suggests that the purpose of the statute is as the prosecution contends.

The courts, as discussed above, also have looked with heightened scrutiny at conflicting signals to defendants, even in the

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[244] *Id.* at 10–11.

[245] United States v. Preston, 739 F. Supp. 294 (W.D. Va. 1990). The provision at issue in *Preston*, 21 U.S.C. § 841(b)(1)(A), while contained in a different subparagraph, was part of the same act as that at issue in *Colon-Ortiz*, 21 U.S.C. § 841(b)(1)(B), and used the same "or both" language. *Preston*, 739 F. Supp. at 300. The court also noted that the two subparagraphs had identical legislative histories. *Id.* at 301.

[246] *Preston*, 739 F. Supp. at 301.

[247] *Id.* at 302–03.

[248] *Id.* at 300–01.

[249] United States v. Cardiff, 344 U.S. 174, 175–76 (1952).

context of penalty provisions. The argument for conflicts in sentencing provisions should be considerably less compelling than for substantive offenses. The message given by a contradiction in a penal statute that erroneously gives the impression of a lighter punishment, as in the case of the "or both" language in *Colon-Ortiz* and *Preston*, is that society considers the underlying substantive offense to be a less egregious crime than other offenses with more severe punishments. Yet the message is still that such conduct is condemned or at least is conduct that society wants to discourage. However, where the conflict goes to the substantive offense, the message is that the conduct is entirely innocent. This situation occurs when parents rely on prayer-exemption statutes. The message of the government through an exemption is that it is proper to treat one's child with prayer, just as in *Chalmers* the court concluded that the message sent by the City Council, despite its intention, was that pushcart vendors were permitted to stop their pushcarts for short durations to sell their wares. Indeed, the language in the prayer-exemption statutes in many states purports to define the proper standard of care rather than merely provide a defense.[250] They therefore create a misleading conflict with the manslaughter statutes, resulting in a failure to provide notice sufficiently clear to satisfy the Due Process Clause.

C. *Reliance on Narrow and Precise Statutory Language*

Another special application of the due process notice doctrine relevant to the prayer-exemption cases is the concept of reliance on narrow and precise statutory language, set forth in *Bouie v. City of Columbia*.[251] In *Bouie*, the Court overturned a ruling by the Supreme Court of South Carolina that the state's criminal trespass statute, which prohibited entering land "after notice from the owner or tenant prohibiting such entry,"[252] applied to the defendants, who did not enter the land over the owner's objection but merely remained on the property after being told to leave by the owner.[253] The Court held that such retroactive

[250] *See supra* note 42.
[251] 378 U.S. 347 (1964).
[252] *Id.* at 349–50.
[253] *Id.* at 355.

expansion, in light of the clear statutory language, violated the Due Process Clause.[254]

The Court cited several vagueness cases as authority, but noted that this case appeared to be the exact opposite of vagueness, since the statute was perfectly clear.[255] However, the Court noted that there is "a potentially greater deprivation of the right to fair notice in this sort of case, where the claim is that a statute precise on its face has been unforeseeably and retroactively expanded by judicial construction, than in the typical 'void for vagueness' situation."[256] The Court explained:

> When a statute on its face is vague or overbroad, it at least gives a potential defendant some notice, by virtue of this very characteristic, that a question may arise as to its coverage, and that it may be held to cover his contemplated conduct. When a statute on its face is narrow and precise, however, it lulls the potential defendant into a false sense of security, giving him no reason even to suspect that conduct clearly outside the scope of the statute as written will be retroactively brought within it by an act of judicial construction.[257]

Because no South Carolina court previously had extended the trespass statute to include the defendants' conduct, under the Due Process Clause they could not be prosecuted under the statute. However, the Court noted that now that a court in South Carolina had so ruled, prosecution for remaining on property over the owner's objections would be permissible as to future defendants.[258]

As with the vagueness doctrine generally, the validity of *Bouie* is unquestionable but its reach is unclear. Courts are often quite generous to defendants in applying the "narrow and precise" principle. In *Douglas v. Buder*,[259] the Court applied the "narrow and precise" concept to bar a finding that a parolee was in violation of the terms of his parole for failing to report a traffic citation. The terms of his parole required him to report "[a]ll arrests . . . without delay" to his probation and parole officer.[260] The Court held that since there was no prior construction that

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[254] *Id.* at 363.
[255] *Id.* at 351–52.
[256] *Id.* at 352.
[257] *Id.*
[258] *Id.* at 362.
[259] 412 U.S. 430 (1973).
[260] *Id.* at 430.

treated a traffic citation as an arrest, the parolee was entitled to rely on a literal interpretation of "arrest."[261] Examples of recent applications of the "narrow and precise" principle in the lower courts to bar prosecutions include the reliance of a video store owner on an anti-pornography statute barring the sale of pornography but stating nothing about the rental of such tapes,[262] and the reliance of protesters on a trespassing statute, similar to the one in *Bouie*, under which the defendants were prosecuted for entering a section of a hospital that had signs posted prohibiting entry, although there was no general warning prohibiting entry into the hospital itself and the trespassing statute focused on the entry into the building or property.[263]

The Seventh Circuit recently rejected the application of the *Bouie* "narrow and precise" principle in *United States v. Drasen*.[264] The court held that it was not inconsistent with *Bouie* to prosecute defendants for selling parts kits capable of being assembled into short-barrel rifles under the National Firearms Act,[265] which bars the sale of short-barrel rifles. The court based its decision on the reasoning that it could not believe that Congress intended to create a loophole for the sale of rifle parts. The court wrote: "If the so-called loophole was intentional, then Congress's reasoning escapes us."[266] In an impassioned dissent, Judge Manion argued in favor of affirming the district court's holding[267] that the prosecution violated due process because it did not give fair notice to the defendants. He argued that "[f]air notice means that people should not have to speculate on how Congress (or a court) applies 'common sense' when determining whether conduct is illegal."[268] He correctly placed the emphasis on the individual who is subject to the law's prohibitions and who relies on narrow and precise language, rather than on the subjective intentions of Congress. Following Judge Manion's argument, the Court of Appeals for the Federal Circuit, in *Thompson/Center Arms Co. v. United States*, rejected the *Drasen* majority's reasoning.[269]

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[261] *Id.* at 432.
[262] State v. Applause Video, Inc., 434 N.W.2d 864 (Iowa 1989).
[263] Cohen v. Katsaris, 530 F. Supp. 1092 (N.D. Fla. 1982).
[264] 845 F.2d 731 (7th Cir.), *cert. denied*, 488 U.S. 909 (1988).
[265] 26 U.S.C. §§ 5801–5849 (1988).
[266] *Drasen*, 845 F.2d at 734.
[267] United States v. Drasen, 665 F. Supp. 598 (N.D. Ill. 1987) (dismissing indictments), *rev'd*, 845 F.2d 731 (7th Cir.), *cert. denied*, 488 U.S. 909 (1988).
[268] *Drasen*, 845 F.2d at 739 (Manion, J., dissenting).
[269] 924 F.2d 1041 (Fed. Cir.), *aff'd*, 112 S. Ct. 2102 (1991).

The prayer-exemption cases seem to fit more closely with the *Bouie* line of cases than with the standard vagueness cases. *Bouie* and subsequent cases emphasize that if a person consults a precise statute, the notice problem is far graver than with the typical vague statute. At least with vague statutes, as the court in *Bouie* noted, persons consulting a vague law may feel compelled to investigate further and try to clarify what the law really is saying. However, a person coming upon a clear statute usually will end her inquiry there. Christian Scientists, as the *McKown* court noted, often are aware of the prayer exemptions and their wording.[270] While not stating that they apply to manslaughter, these exemptions are worded in such a way that they lull potential defendants in a manner prohibited by *Bouie*.[271] As Professor Tribe noted in his certiorari petition in *Walker*, the defendants had no prior cases to go on, and scant legislative history.[272] All they had to look to was the wording of the statute.

D. *Vagueness and Religion*

The application of the vagueness doctrine reflects an awareness of underlying constitutional values. As discussed earlier, a statute's implication of underlying constitutional rights triggers heightened review of the notice given defendants and the standards set for law enforcement officials. This concept is easy to apply where the activity implicated by the challenged statutes falls clearly within a class of activities protected by the Constitution. For example, it is clear that a vague flag desecration statute, such as that in *Smith v. Goguen*, could implicate constitutionally recognized rights of expression.

However, in the prayer-exemption cases, the activity involved, a parent's decision to use prayer in lieu of medical treatment for his or her child, is probably not, as I have argued, a right under the Free Exercise Clause. Still, these cases do touch upon a parent's freedom of religion. Parents' constitutional right to *believe* that prayer healing is the best route to health is beyond dispute. Furthermore, the First Amendment would also protect a parent's right to pray for his or her child's

[270] *See* State v. McKown, 475 N.W.2d 63 (Minn. 1991), *cert. denied*, 112 S. Ct. 882 (1992).

[271] *See* Bouie v. City of Columbia, 378 U.S. 347 (1964).

[272] Tribe Petition, *supra* note 72, at 12.

health, even though prayer is an act.[273] Also affected is the right of parents, recognized in *Yoder*, to direct the religious upbringing of their children. Prosecuting for manslaughter parents who, for religious reasons, fail to provide medical care to their children therefore at least touches upon religious freedom.

The Supreme Court has struck down statutes that touched on religious freedoms as void for vagueness. However, these cases involved not only issues of free exercise, but also of free speech.[274] Given the extreme sensitivity of the courts toward vague statutes that touch on speech, the impact of religious freedom on the level of scrutiny in the vagueness review should not be overemphasized. However, a number of cases in both federal and state courts have struck down statutes on vagueness grounds that affected the free practice of religion without implicating free speech as well.

While it is generally held that municipalities may use their zoning power to regulate the location of churches and other places of worship in a community without violating the Free Exercise Clause,[275] courts have struck down such zoning statutes on vagueness grounds, applying the heightened vagueness scrutiny used in First Amendment cases. In *State v. Cameron*,[276] the New Jersey Supreme Court held that an ordinance barring "churches and similar places of worship"[277] from a residential zone was unconstitutionally vague as applied to a minister of a small church that, due to insufficient funds to obtain other space, held its religious services in the minister's home on Sundays. Attendance at these services did not exceed twenty-five per-

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[273] One would be hard pressed to concoct a generally applicable criminal law that only incidentally would prohibit private prayer.

[274] *See* Kunz v. New York, 340 U.S. 290 (1951) (holding that statute regulating public worship was unconstitutionally vague); Cox v. New Hampshire, 312 U.S. 569 (1941) (rejecting vagueness challenge by Jehovah's Witnesses to statute requiring parade license); Cantwell v. Connecticut, 310 U.S. 296 (1940) (religious solicitation statute unconstitutionally vague). In many vagueness challenges to statutes, litigants throw in a reference to the statute's impact on freedom of religion as a matter of course, as in charging that a curfew law impinges on the right of minors to attend religious activities. *See, e.g.*, Johnson v. City of Opelousas, 658 F.2d 1065 (5th Cir. 1981).

[275] *See* Messiah Baptist Church v. County of Jefferson, 859 F.2d 820 (10th Cir. 1988), *cert. denied*, 490 U.S. 1005 (1989); Colorado Springs v. Blanche, 761 P.2d 212, 216, 217 n.5 (Colo. 1988) (noting that "a majority of jurisdictions have held these types of ordinances to be constitutional," and also noting "the United States Supreme Court's repeated dismissal of appeals from state court decisions upholding the constitutionality of zoning laws which restrict the location of religious institutions").

[276] 498 A.2d 1217 (N.J. 1985).

[277] *Id.* at 1218.

sons.[278] Similarly, a federal district court in *Nichols v. Planning & Zoning Commission*[279] struck down a zoning regulation on its face which barred a "church, parish hall, or other religious use"[280] when that ordinance was enforced against a minister who held religious services attended by up to ten followers in his home.[281] The court held that "where a vague statute abuts sensitive areas of basic first amendment freedoms, it operates to inhibit the exercise of those freedoms."[282] The court noted that the statute did not give the average person fair warning of the statute's sweep, such as whether it extended to such activities as a Passover Seder or a bible discussion.[283] In contrast to these two cases, the Supreme Court of Colorado rejected a vagueness challenge to a statute similar to that in *Cameron* as applied to a pastor who had held services in his house four times per week with an attendance of sixty to seventy-five people.[284]

Courts have had mixed responses to vagueness challenges to compulsory education statutes. One district court found that a Pennsylvania statute allowing an exemption for children taught by tutors did not provide sufficient standards of who would qualify as a tutor.[285] The court held that the compulsory education statute was thus unconstitutional because it failed to give adequate notice of whether parents could be found criminally liable for teaching their children at home for religious reasons. Although a district court similarly struck down on vagueness grounds Missouri's compulsory education statute, which required that home schooling be "substantially equivalent" to standard schooling, the Court of Appeals reversed without opinion.[286] A challenge to Idaho's compulsory education statute also has been rejected.[287]

There have been other cases rejecting vagueness challenges to statutes that touch on religious freedom. For example, the Vermont Supreme Court rejected such a challenge to a statute prohibiting the practice of medicine without a license as applied

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[278] *Id.* at 1226.
[279] 667 F. Supp. 72 (D. Conn. 1987).
[280] *Id.* at 75.
[281] *Id.*
[282] *Id.* at 77.
[283] *Id.*
[284] Colorado Springs v. Blanche, 761 P.2d 212 (Colo. 1988).
[285] Jeffrey v. O'Donnell, 702 F. Supp. 516 (M.D. Pa. 1988).
[286] Ellis v. O'Hara, 612 F. Supp. 379 (E.D. Mo. 1985), *rev'd without opinion*, 802 F.2d 462 (8th Cir. 1986).
[287] Bayes v. State, 785 P.2d 660 (Idaho Ct. App. 1989).

to a member of a religious community who had sutured a wound and surgically removed a wart.[288] Other examples include numerous challenges to the Internal Revenue Code's civil penalty provisions for filing frivolous returns in the context of taxpayers protesting military spending on religious grounds.[289]

The cases demonstrate that there is no guarantee that a court presented with an unclear law that touches on religious freedom will automatically strike it down. However, the cases illustrate that courts are at least sensitive to the protection of religious freedom through vagueness review. Furthermore, the Supreme Court's decision in *Smith*—that generally applicable laws prohibiting or requiring certain activities cannot be challenged under the Free Exercise Clause—provides an even greater reason for heightened vagueness review. The rationale of *Smith* is that we must allow the legislature to create general laws that will bind all citizens. Though these laws may incidentally affect religious freedom, according to *Smith* this is a necessary evil of the smooth functioning of the law. It is not inconsistent with this to require the legislature to act with particular clarity where the legislature's general laws affect religious freedom. Thus, while *Smith* subjects those who seek to exercise religious freedom to generally applicable laws, it seems fair under the Due Process Clause, informed by the Free Exercise Clause, to require that the legislature be clear as to what those generally applicable laws are.

III. Misinterpretations of the Law Based on Unintentional Governmental Vagueness

The vagueness doctrine strongly supports the argument that parents who rely on a statutory prayer exemption are not on notice that they may be liable for manslaughter. The doctrine focuses on the potential defendant's perception, regardless of

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[288] State v. Cantrell, 558 A.2d 639 (Vt. 1989).

[289] Nelson v. United States, 796 F.2d 164 (6th Cir. 1986) (holding that statute providing civil penalty for filing "frivolous" tax return was not vague as applied to Quaker who deducted from her return an amount proportionate to the percentage of tax collections allotted for military spending); Welch v. United States, 750 F.2d 1101 (1st Cir. 1985); Drefchinski v. Regan, 589 F. Supp. 1516 (W.D. La. 1984); Harper v. United States, 587 F. Supp. 1056 (E.D. Pa. 1984), *aff'd without opinion*, 760 F.2d 257 (3d Cir. 1985); *see also* Assembly of Yahveh Beth Israel v. United States, 592 F. Supp. 1257 (D. Colo. 1984) (holding that statute conferring investigatory powers on Internal Revenue Service was not vague as applied to investigation of church's finances).

the government's intention. Part II explored cases where the government intended to make a certain activity criminal, but did so without giving the defendant adequate notice. However, the prayer-exemption statutes contain an additional dimension: there is at least some degree of prayer treatment that the state intentionally permits. The courts are especially sensitive to situations in which a defendant misunderstands his obligations under the law as a result of the state's instruction. Part III analyzes this area of the law, as developed in the *Raley* and *Cox* decisions, and parallel developments in the law. It begins with a discussion of the principle that "ignorance of the law is no excuse," to which the *Raley/Cox* doctrine is an exception.

A. *Ignorance and Mistake of the Law*

As the Supreme Court recently reiterated, "[t]he general rule that ignorance of the law or a mistake of law is no defense to criminal prosecution is deeply rooted in the American legal system."[290] Although the rule has been codified in many states,[291] such codification is unnecessary because it is "a principle so universally accepted as to be axiomatic."[292]

The presumption that all citizens know the law is, of course, a fiction.[293] It is a principle rooted in expediency. Professor Austin wrote that the principle was based on the factual problem of determining whether a defendant truly was ignorant of the law.[294] Justice Holmes, a staunch defender of the rule, argued instead that "[t]he true explanation of the rule is the same as that which accounts for the law's indifference to a man's particular temperament, faculties and so forth. Public policy sacrifices the individual to the general good."[295] To Holmes, the principle against providing an excuse for ignorance or mistake

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[290] Cheek v. United States, 111 S. Ct. 604, 609 (1991).

[291] *See, e.g.*, ARIZ. REV. STAT. ANN. § 13-204(B) (1991) ("Ignorance or mistake as to a matter of law does not relieve a person of criminal responsibility."); IOWA CODE § 701.6 (1991) ("All persons are presumed to know the law."); OKLA. STAT. tit. 21, § 152 (1991) ("[I]gnorance of the law does not excuse from punishment for its violation."); TEX. PENAL CODE ANN. § 8.03(a) (West 1992) ("It is no defense to prosecution that the actor was ignorant of the provisions of any law after the law has taken effect.").

[292] 21 AM. JUR. 2D *Criminal Law* § 142 (1981).

[293] *See* JEROME HALL, GENERAL PRINCIPLES OF CRIMINAL LAW 343 (1947) ("No one now believes it is actually possible to know the law.").

[294] JOHN AUSTIN, LECTURES ON JURISPRUDENCE 497 (4th ed. 1879), *cited in* HALL, *supra* note 293, at 346.

[295] OLIVER WENDELL HOLMES, JR., THE COMMON LAW 48 (1881).

of law was no different from the objective nature of the law generally.

If all law were derived from natural law, or at least were based on universally-shared societal norms, the notion that citizens know the law would be more accurate.[296] On the other hand, the more that law is seen as positive in nature, the more the presumption that all citizens know the law loses its force as a descriptive statement, and instead, becomes a mere expedient. The same principle applies to particular laws within the legal system. Our penal laws cover a broad spectrum, from those which reflect deep senses of moral condemnation (*malum in se*), such as rape, to regulatory laws (*malum prohibitum*), the violation of which could be confessed in polite company. The more a particular law approaches the latter, the less force there is to the presumption that all persons know the particular law.[297] In recognition of this concept, the Utah Supreme Court has held that with purely *malum prohibitum* statutes the state must prove actual knowledge of the statute in order to prosecute.[298]

Numerous commentators have criticized the maxim "*ignorantia facti excusat, ignorantia juris non excusat.*"[299] A British jurist made a particularly colorful criticism some years ago in exclaiming, "everybody is presumed to know the law except His Majesty's judges, who have a Court of Appeal set over them to put them right."[300] Professors Ryu and Silving's *Error Juris: A Comparative Study*[301] provides one of the most thoughtful criticisms of the rule. They disagree that the law must disregard ignorance of the law, arguing that doing so "confuses the subjective value judgment of responsibility, as relating to the par-

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[296] *See* Livingston Hall & Selig J. Seligman, *Mistake of Law and Mens Rea*, 8 U. CHI. L. REV. 641, 644 (1941) ("[T]he fact that crimes are also generally sins is one of the practical justifications for requiring a man to know the criminal law.") (quoting HOLMES, *supra* note 295 at 125); Paul K. Ryu & Helen Silving, *Error Juris: A Comparative Study*, 24 U. CHI. L. REV. 421, 430 (1957); Bruce R. Grace, Note, *Ignorance of the Law as an Excuse*, 86 COLUM. L. REV. 1392, 1395–96 (1986).

[297] *See* HALL, *supra* note 293, at 354–55.

[298] State v. Granato, 610 P.2d 1290 (Utah 1980) (overturning conviction under statute prohibiting representatives of liquor distilleries from making political contributions because the defendant did not have actual knowledge of the statute).

[299] "Ignorance of a fact is an excuse, ignorance of the law is not an excuse." *See, e.g.*, Jeffries, *supra* note 180, at 208–12; Edward L. Rubin, *Law and Legislation in the Administrative State*, 89 COLUM. L. REV. 369, 405 n.124 (1989); David De Gregorio, Comment, People v. Marrero *and Mistake of Law*, 54 BROOK. L. REV. 229 (1988); Grace, *supra* note 296.

[300] GLANVILLE WILLIAMS, CRIMINAL LAW THE GENERAL PART 290 (1961) (attributing the statement to Maule, J.).

[301] *Supra* note 296.

ticular defendant, with the objective value judgment of illegality. A person's act performed in ignorance of law remains illegal. This does not preclude his being held not responsible for it."[302] They also disagree with Holmes's argument that it is the policy of the law to force external conformity to it, reasoning that it "is contrary to the basic democratic principle that man should not be used as a means to an end."[303]

Maintaining this harsh common law rule, which does not permit even a reasonable mistake of law defense, seems inconsistent with the trend in procedural due process to move away from Holmes's notion that even where it is reasonable and feasible to yield to the individual, it is tolerable to "sacrifice[ ] the individual to the general good." In prominent cases holding that the Due Process Clause requires a hearing before the termination of welfare benefits[304] and fair notice before the seizure of property,[305] the Supreme Court has favored the rights of individuals over the convenience and expedience of the government. This same spirit, which rejects the notion of "sacrific[ing] the individual to the general good," can be applied to require the unbending law to yield and excuse ignorance or mistakes of law in those cases where the mistakes are reasonable and where the government's interest in punishing the ignorant or mistaken defendant is low.

Some courts and commentators have distinguished ignorance of the law from mistake of law.[306] They have been more willing to excuse an offense where, rather than acting oblivious to legal responsibilities, a defendant has attempted to conform his or her conduct to them. As the Delaware Supreme Court has noted:

> [I]t seems to us significantly different to disallow mistake of law where . . . it appears that before engaging in the conduct, the defendant made a bona fide, diligent effort, adopting a course and resorting to sources and means at least as appropriate as any afforded under our legal system, to ascertain

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[302] *Id.* at 433.

[303] *Id.* (citing Immanuel Kant, *Grundlegung zur Metaphysik der Sitten*, *in* 8 KANT, GESAMMELTE WERKE 57 (Rosenkranz ed., 1838)).

[304] Goldberg v. Kelly, 397 U.S. 254 (1970).

[305] Fuentes v. Shevin, 407 U.S. 67 (1972) (replevin); Sniadach v. Family Finance Corp., 395 U.S. 337 (1969) (garnishment of wages).

[306] *See, e.g.*, Jeffries, *supra* note 180, at 208; Edwin R. Keedy, *Ignorance and Mistake in the Criminal Law*, 22 HARV. L. REV. 75, 88–96 (1908); De Gregorio, *supra* note 299, at 249 n.94.

> and abide by the law, and where he acted in good faith reliance upon the results of such effort.[307]

New Jersey provides a mistake of law defense where a defendant diligently attempts to ascertain the law and "in good faith concludes his conduct is not an offense in circumstances in which a law-abiding and prudent person would also so conclude,"[308] but is the only jurisdiction to have gone this far.[309]

Notwithstanding the consistency with which courts recite the *ignorantia juris* maxim, the Supreme Court has signaled some willingness to move away from it in some instances. In *Liparota v. United States*,[310] the Court overturned a conviction under a statute prohibiting the knowing acquisition of food stamps in a manner not authorized by law. The defendant in *Liparota* claimed that he did not know that it was illegal to purchase food stamps for cash at less than face value. The Court insisted that this was merely a mistake of fact case analogous to cases of receiving stolen property. The Court reasoned that a defendant who did not know that his manner of acquisition was unauthorized had made a mistake of fact. While the Court stated that it was not creating a mistake of law defense,[311] the dissent and at least one commentator noted that the Court's result necessarily implies a departure from the "ignorance of the law is no excuse" rule.[312]

Similarly suggestive of a departure from the *ignorantia juris* maxim, the Supreme Court, in striking down on due process grounds a law that punished non-feasance, noted that the av-

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[307] Long v. State, 65 A.2d 489, 497 (Del. 1949).

[308] N.J. Rev. Stat. § 2c:2-4(c)(3) (1991).

[309] Other jurisdictions provide a mistake of law defense only where the defendant has been misled by the government. *See* statutes cited *infra* note 351.

[310] 471 U.S. 419 (1985).

[311] *Id.* at 425 n.9.

[312] *See id.* at 437 (White, J., dissenting); Grace, *supra* note 296, at 1399–400. The Court's comparison of its holding to the requirement that a person must know property is stolen in order to be convicted of receiving stolen property is inapt. The claim of a person accused of receiving stolen property is not that he did not know that it was a crime to steal, but rather that he did not know that stealing was how the seller came to possess the property. Distinguish this situation from one in which someone claims, as a defense to receiving stolen property, that the seller took the property from his employer but that the purchaser did not know that embezzlement was stealing (and therefore illegal). Such a claim would seem to run afoul of the *ignorantia juris* maxim. Were the defendant to succeed in such a case, it seems clear that the Court would have created a mistake of law defense. This is precisely what the Court did in *Liparota*. While in a formalistic sense the defendant in *Liparota* was still presumed to know that a crime existed for receiving food stamps in a manner unauthorized by law, he was given a defense for not knowing which manner of receiving food stamps was authorized by law and which was not authorized.

erage citizen would have neither actual notice of the statute nor reason to know about it. In *Lambert v. California*,[313] the Court overturned a California statute requiring convicted felons to register with the government within five days of entering the state. The Court found that because the defendant did not know about the registration requirement and was "wholly passive"[314] in the sense that all that she had done to trigger the statute was enter the state, the due process principle of fair notice barred prosecution. The Court stated: "Where a person did not know of the duty to register and where there was no proof of the probability of such knowledge, he may not be convicted consistently with due process."[315] The Court thus proceeded one step beyond the vagueness requirement that a person who actually consults the law must receive notice of what is expected of him: it held that, at least with regard to punishing omissions, the state may not punish conduct which a person would have no reason to believe was illegal unless he or she consults the law.

Commentators challenging the doctrine of *ignorantia juris* cite *Liparota* and *Lambert*, but there is little other authority.[316] Despite the forceful language of *Lambert* regarding notice, *ignorantia juris* is still in force. Professor Jeffries notes that the continued existence of *ignorantia juris* is telling evidence of how the Court generally employs strong rhetoric on the issue of notice but applies the due process principle of notice haphazardly and sparingly, as seen in vagueness and lenity analysis.[317] However, Jeffries adds that "there is a core concept of notice as a requirement of fairness to individuals that is, and should be, taken very seriously."[318] A defendant being prosecuted under a vague statute or a statute of which most people would not be aware cannot be assured that courts will be able to apply a coherent doctrine to strike down the statute. Nonetheless, such a defendant probably can assume that courts will be sensitive to notice and are prepared to strike down statutes that stretch too far the limits on the notice ideal that we tolerate for the sake of expediency.

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[313] 355 U.S. 225 (1957).
[314] *Id.* at 228.
[315] *Id.* at 229–30.
[316] *See, e.g.*, Jeffries, *supra* note 180, at 211–12; Grace, *supra* note 296, at 1401–03, 1408–09.
[317] Jeffries, *supra* note 180, at 210–11.
[318] *Id.* at 211.

B. *The Doctrine of Reliance in the Supreme Court*

One area in which the Court has cut back on the *ignorantia juris* principle and has elevated the ideal of notice is in cases in which a defendant's misinterpretation of the law has been caused by his reliance on the government's assertion of what the law is. The principal cases in this area are *Raley v. Ohio* and *Cox v. Louisiana*, both cited by the Minnesota Supreme Court in *McKown*.[319]

The reliance argument has strong intuitive appeal and further builds on the general criticisms of the *ignorantia juris* principle that it is intolerable to treat individuals as means to an end.[320] Punishing those who reasonably have relied on the government runs counter to the proper relationship of sovereign and subject in a free society. As one court put it, punishing someone who has relied on official advice "is akin to throwing water on a man and arresting him because he's wet."[321] Or, as another court wrote in 1858, which remains just as salient today, "[m]en naturally trust in their government, and ought to do so, and they ought not to suffer for it."[322]

Raley represents an extension of *Johnson v. United States*,[323] in which the Supreme Court held that a prosecutor could not comment on a defendant's invocation of the privilege against self-incrimination when the judge erroneously told the defendant that he could invoke the privilege on cross-examination.[324] The courts of appeal have developed a similar doctrine restraining the prosecution of individuals who rely on statements of the judicial branch. Under this doctrine, a defendant may not be prosecuted if he or she relies on a ruling by a federal court that is later found to be erroneous, provided that the federal court's ruling involved that defendant.[325]

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[319] State v. McKown, 475 N.W.2d 63, 68 (Minn. 1991), *cert. denied*, 112 S. Ct. 882 (1992).

[320] *See* Ryu & Silving, *supra* note 296.

[321] People v. Studifin, 504 N.Y.S.2d 608, 610 (Sup. Ct. 1986).

[322] Menges v. Dentler, 33 Pa. 495, 500 (Pa. 1858), *quoted in* Floyd D. Shimomura, *Federal Misrepresentation: Protecting the Reliance Interest*, 60 TUL. L. REV. 596, 650 (1986). Professor Shimomura also quotes the Ninth Circuit: "To say to these appellants, 'The joke is on you. You shouldn't have trusted us,' is hardly worthy of our great government." Brandt v. Hickel, 427 F.2d 53, 57 (9th Cir. 1970).

[323] 318 U.S. 189 (1943).

[324] *Id.*

[325] United States v. Albertini, 830 F.2d 985 (9th Cir. 1987) (holding that protester who relied on circuit court's ruling, which was later overruled by the Supreme Court, that his protest on Air Force base was protected by the First Amendment, could not be

In another pre-*Raley* and *Cox* case, *Moser v. United States*,[326] the Court held that certain actions by the State Department had misled the petitioner, a Swiss citizen, into erroneously believing that he would not be debarred from United States citizenship in the future by claiming an exemption to the draft. The Court held that the petitioner could not be debarred from citizenship because "elementary fairness" required that the petitioner waive his right to apply for United States citizenship knowingly. The Court noted that "[t]o hold otherwise would be to entrap petitioner."[327] Though similar to *Raley*, "*Moser* has not spawned a line of cases based explicitly on due process" in the non-criminal context.[328]

Citing *Raley* and *Cox*, the Court in *United States v. Pennsylvania Industrial Chemical Corp.*[329] held that the defendant could not be prosecuted for violating an 1899 environmental statute prohibiting the discharge of pollutants into navigable rivers. The Court so held despite the finding that defendant's actions fell within the act's prohibitions, on the ground that the defendant had been misled by regulations of the Army Corps of Engineers into believing that the law only applied to discharges that interfered with navigation. The Corps of Engineers' regulations, while not specifically stating that the law did not apply to all discharges into navigable rivers, focused exclusively on those discharges affecting navigation, and thereby, the Court held, misled the defendant. That is, the regulations lulled the defendant into believing that the specified discharges were the only ones that the law prohibited. The Court thus found that since "the regulations deprived [defendant] of fair warning as to what conduct the Government intended to make criminal, we think there can be no doubt that traditional notions of fairness inherent in our system of criminal justice prevent the Government from proceeding with the prosecution."[330]

The Court in *Pennsylvania Industrial Chemical*, *Raley*, and *Cox* seems to have adopted an estoppel defense in criminal

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prosecuted for engaging in similar protests on Navy base prior to the reversal); United States v. Mancuso, 139 F.2d 90 (3d Cir. 1943) (holding that draftee who relied on district court's erroneous order enjoining enforcement of an induction order could not be prosecuted for failure to appear for induction).

[326] 341 U.S. 41 (1951).

[327] *Id.* at 47.

[328] Floyd D. Shimomura, *Federal Misrepresentation: Protecting the Reliance Interest*, 60 TUL. L. REV. 596, 642 (1986).

[329] 411 U.S. 655 (1973).

[330] *Id.* at 674.

cases. In *Pennsylvania Industrial Chemical*, this adoption of an estoppel defense is evidenced by the Court's citation of an influential note in the *Yale Law Journal*. The author of this note states that "if the Supreme Court chooses to follow the logic of *Raley* and *Cox*, it must end by replacing the no-estoppel rule in criminal prosecutions with some sort of due process-estoppel defense."[331]

The federal courts have expanded the *Raley/Cox* doctrine even so far as to encompass a mistake of law based on erroneous advice given by federally licensed firearms dealers.[332] The circuit courts have adopted the term "entrapment by estoppel" to describe the *Raley/Cox* due process concept. The term first appeared in a published decision in 1985[333] and has been accepted rapidly by the circuit courts.[334] Courts have used the term to describe misleading not only by government agents acting in an executive capacity, but also by court rulings. These decisions emphasize that misleading by governmental action, in whatever form, is the focus of the *Raley/Cox* doctrine.[335]

The development of an "entrapment-by-estoppel" rule in *Raley* and *Cox* contrasts with the unavailability of estoppel against the government in other contexts, such as where misleading statements by the government lead to actions in tort,[336]

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[331] Note, *Applying Estoppel Principles in Criminal Cases*, 78 YALE L.J. 1046, 1050 (1969).

[332] United States v. Clegg, 846 F.2d 1221 (9th Cir. 1988); United States v. Tallmadge, 829 F.2d 767 (9th Cir. 1987); *see also* United States v. Smith, 940 F.2d 710 (1st Cir. 1991) (accepting principle but finding that defendant had not been misled); *cf.* United States v. Etheridge, 932 F.2d 318 (4th Cir.) (accepting entrapment-by-estoppel principle in context of misinterpretation of firearms law but holding it inapplicable where defendant relied on *state* judge's advice as to *federal* firearms law), *cert. denied*, 112 S. Ct. 323 (1991); United States v. Brady, 710 F. Supp. 290 (D. Colo. 1989) (overturning conviction of trapper for federal offense of possession by a convicted felon of a firearm where the defendant had relied on state judge's advice that he could use a gun for hunting and trapping). *But see* United States v. Austin, 915 F.2d 363 (8th Cir. 1990) (accepting entrapment-by-estoppel principle in context of firearms laws, but holding that the principle applies only to reliance on true government officials and not to reliance on federally licensed firearm dealers), *cert. denied*, 111 S. Ct. 1626 (1991).

[333] United States v. Hsieh Hui Mei Chen, 754 F.2d 817, 825 (9th Cir.), *cert. denied*, 471 U.S. 1139 (1985).

[334] *See, e.g.*, *Smith*, 940 F.2d 710; *Etheridge*, 932 F.2d 318; *Austin*, 915 F.2d 363; United States v. Hedges, 912 F.2d 1397 (11th Cir. 1990) (reversing conviction of Air Force colonel who relied on Standards of Conduct Officer to interpret conflict-of-interest law).

[335] *Etheridge*, 932 F.2d 318; *Brady*, 710 F. Supp. 290.

[336] The Federal Torts Claims Act states that the government preserves its sovereign immunity for "[a]ny claim arising out of misrepresentation [and] deceit." 28 U.S.C. § 2680(h) (1991).

denial of welfare benefits,[337] denial of civil service benefits,[338] or where such statements affect tax liability.[339] The Court in *Heckler v. Community Health Services* noted, however, that it has refused to adopt "a flat rule that estoppel may not in any circumstances run against the Government."[340] The Court stated that *Pennsylvania Industrial Chemical* and *Moser* represent exceptions for criminal defendants and those facing the loss of citizenship,[341] and cited two recent cases suggesting something of a departure from the no-estoppel rule.[342]

Despite the generally limited applicability of estoppel to the government, the federal courts have firmly established a doctrine for criminal defendants. Defendants allegedly misled by the government may claim that they did not receive proper notice that they were engaging in criminal conduct. The doctrine applies throughout the branches of government: to independent actors in the executive branch,[343] to agencies in their promulgation of regulations,[344] to the members of the judiciary acting through advice,[345] to judges' decisions,[346] to members of the legislature,[347] and, through the vagueness doctrine, to the legislature as a body.

One might argue that the vagueness doctrine is more concerned with protecting the defendant from government-created confusion than with preventing misleading.[348] The distinction between these two concerns emerges only if one focuses on the

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[337] Heckler v. Community Health Serv., Inc., 467 U.S. 51 (1984), *cert. denied*, 474 U.S. 1056 (1986); Schweiker v. Hansen, 450 U.S. 785 (1981).

[338] Office of Personnel Management v. Richmond, 496 U.S. 414 (1990).

[339] *See, e.g.*, United States v. Federal Deposit Ins. Corp., 805 F.2d 1012 (Fed. Cir. 1986), *cert. denied*, 481 U.S. 1048 (1987).

[340] *Heckler*, 467 U.S. at 60.

[341] *Id.*

[342] *Id.* The two recent cases cited were Kaiser Aetna v. United States, 444 U.S. 164 (1979) (holding that acquiescence of Army Corps of Engineers in plan to dredge salt water pond and create navigable waterway created a property interest in the owner, such that the government could not require the owner to provide access to the public without exercising its power of eminent domain and compensating the owner), and Santobello v. New York, 404 U.S. 257 (1971) (finding that where defendants agreed to plead guilty in exchange for promise from prosecutor to make no sentencing recommendation, due process was violated when prosecutor's successor recommended the maximum sentence at the sentencing hearing).

[343] Cox v. Louisiana, 379 U.S. 559 (1965).

[344] United States v. Pennsylvania Indus. Chem. Corp., 411 U.S. 655 (1973).

[345] Johnson v. United States, 318 U.S. 189 (1943).

[346] *E.g.*, United States v. Albertini, 830 F.2d 985 (9th Cir. 1987).

[347] Raley v. Ohio, 360 U.S. 423 (1959).

[348] Cases such as United States v. Cardiff, 344 U.S. 174 (1952), involving vagueness created by contradictory commands, are closer in form to the misleading cases than the vagueness cases generally.

type of government action. The government seems more blameworthy when it actively misleads than when it merely is unclear. However, if the focus is shifted from the quality of the government action to the lack of notice afforded a criminal defendant, the line between active misleading and mere lack of clarity becomes less significant. In either case, from the defendant's standpoint, the government has in some way prevented her from knowing what conduct will provoke a criminal sanction. A distinction between types of government action might properly be based on a question of proof: when someone claims a government agent affirmatively misled her, the agent is probably available to testify. Proving that someone actually consulted a statute, and was confused by it, is much more difficult. It would be ironic, however, given the presumption that citizens know the law, to treat misleading through statutes, which defendants are presumed at their peril to know, any less harshly than that caused by government agents.

In most of the cases cited above, the government's proffered interpretation of the law clearly was erroneous. This situation differs somewhat from the prayer-exemption/manslaughter cases, since in those cases the prayer exemption is "correct" (i.e., it is intended by the legislature to be where it is and in the form in which it is). The problem with the exemptions is that they *appear* to set a standard of proper conduct for treating one's children. The prayer-exemption/manslaughter cases are thus very similar to *Pennsylvania Industrial Chemical*, in which everything the regulations said was true. The regulations were defective only in what they did not say: by focusing exclusively on discharges affecting navigation, they misled the defendant into believing that the prohibition was limited to such discharges. In the same manner, parents who consult a prayer-treatment exemption to a child abuse law are misled into believing that the statute provides a definition of the proper conduct to which a parent must conform in treating a child, not merely of the proper conduct for avoiding liability for child abuse.

C. *Mistake of Law in the States*

State courts have applied the *Raley/Cox* doctrine on numerous occasions.[349] A parallel development has been many states'

[349] *See, e.g.*, Ostrosky v. State, 704 P.2d 786 (Alaska Ct. App. 1985) (holding that

adoption of statutes based on Model Penal Code section 2.04, which provides for a mistake of law defense when an actor reasonably relies on an official statement of law, which is later determined to be erroneous, contained in a statute, judicial decision, administrative order, or a statement by certain public officers.[350] At least seventeen states have adopted similar statutes, incorporating from one to all four of these types of reliance.[351] Of these, seven do not employ the "later determined to be erroneous" language, thereby opening the possibility that these statutes could provide a mistake of law defense to reliance on any confusing statute.[352]

There are very few cases interpreting these mistake statutes. However, a review of these cases reveals some trends. Some courts have been quite generous in interpreting what constitutes an official statement of the law. In reversing a conviction, one court held that the question of whether a letter from a public

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reliance on court's ruling that fish and game law was unconstitutional provided defense to fisherman's violation of the law where fisherman read about the ruling in magazine); State v. Berberian, 427 A.2d 1298 (R.I. 1981) (holding that defendant theater operators who had been granted license to show two movies could not be prosecuted under obscenity law); *cf.* Commonwealth v. Geoghegan, 427 N.E.2d 941, 944 (Mass. App. Ct. 1981) (holding that principle applies "only where 'unconscionably misleading conduct' is involved").

[350] MODEL PENAL CODE § 2.04 (3)(b) (1985). The section reads:

> (3) A belief that conduct does not legally constitute an offense is a defense to a prosecution for that offense based upon such conduct when:
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> ....
>
> (b) he acts in reasonable reliance upon an official statement of the law, afterward determined to be invalid or erroneous, contained in (i) a statute or other enactment; (ii) a judicial decision, opinion or judgment; (iii) an administrative order or grant of permission; or (iv) an official interpretation of the law defining the offense.

Id.

[351] ALA. CODE § 13A-2-6(b) (1991); ARK. CODE ANN. § 5-2-206(c) (Michie 1992); COLO. REV. STAT. ANN. § 18-1-504 (2) (West 1991); CONN. GEN. STAT. § 53a-6(b) (1992), HAW. REV. STAT. § 702-220 (1991); ILL. REV. STAT. ch. 38, para. 4-8(b) (1991); KAN. STAT. ANN. § 21-3203(2) (1990); KY. REV. STAT. ANN. § 501.070(3) (Michie/Bobbs-Merrill 1991); ME. REV. STAT. ANN. tit. 17-A, § 36(4) (West 1992); MO. REV. STAT. § 562.031(2) (1992); MONT. CODE ANN. § 45-2-103(6) (1991); N.H. REV. STAT. ANN. § 626:3(II) (1991); N.J. REV. STAT. § 2c:2-4(c)(2) (1992); N.Y. PENAL LAW § 15.20(2) (McKinney 1992); N.D. CENT. CODE § 12.1-05-09 (1991); TEX. PENAL CODE ANN. § 8.03(b) (West 1992); UTAH CODE ANN. § 76-2-304(2)(b) (1991).

[352] ALA. CODE § 13A-2-6(b); CONN. GEN. STAT. § 53a-6(b); N.H. REV. STAT. ANN. § 626:3(II); N. Y. PENAL LAW § 15.20(2); N.D. CENT. CODE § 12.1-05-09; TEX. PENAL CODE ANN. § 8.03(b); UTAH CODE ANN. § 76-2-304(2)(b). The New York Court of Appeals rejected, over an impassioned dissent, a defendant's claim that the state's mistake of law statute should be construed to provide a defense for mistaken reliance on a valid statute in People v. Marrero, 507 N.E.2d 1068 (N.Y. 1987). *See infra* notes 358–366 and accompanying text.

utilities commission to the defendant confused him as to the relevant law was an issue of fact.[353] Others, while upholding convictions, give the trier of fact broad discretion to determine what constitutes both an official pronouncement of the law and reasonable reliance.[354] Other courts have taken the issue away from the jury where the court found the reliance of the defendant to be completely unreasonable.[355]

The courts of two states, perhaps too entrenched in their observance of the *ignorantia juris* principle to permit flexibility, have read their statutes narrowly. The Supreme Court of Colorado has held that its state's mistake of law statute does not apply where the defendant was mistaken about the law, but only where the defendant's conduct was in fact lawful: "A sincere but mistaken belief as to whether particular conduct constitutes an offense is not a defense to prosecution for such conduct under this statute unless the conduct is in fact permitted by statute, administrative regulation or judicial decision."[356] The court's holding, which turned the mistake of law statute into one that merely prevents contradictory statutes, was probably the result of poor drafting. The statute states that "a mistaken belief that [conduct] does not, as a matter of law, constitute an offense" is not an excuse "unless the conduct is permitted by

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[353] State v. Sheedy, 480 A.2d 887 (N.H. 1984) (holding that defendant convicted under state law barring the recording of telephone conversations without consent of the other party should have been permitted to introduce evidence of whether letter from commission regarding scope of its regulatory jurisdiction led him erroneously to believe that federal law, which permits such recording, governed).

[354] State v. Fiocchi, 553 A.2d 181 (Conn. App. Ct.) (reserving for jury the question whether defendant was misled by a police officer's statements regarding when defendant could discharge a firearm at his neighbor's dog), *appeal denied*, 556 A.2d 611 (Conn. 1989); State v. Rohweder, 305 N.W.2d 25 (N.D. 1981) (concluding that evidence was sufficient for jury to conclude that telephone statements to the defendant by veterinarian on State Livestock Sanitary Board did not mislead defendant); Linder v. State, 779 S.W.2d 520 (Tex. Ct. App. 1989) (rejecting bail bondsman's argument that he relied on an 1873 U.S. Supreme Court case, coupled with acquiescence of law enforcement officials, in forming mistaken belief that his conduct in apprehending bail jumper was lawful).

[355] People v. Sevilla, 547 N.E.2d 117, 122 (Ill. 1989) (holding unreasonable defendant's belief that statement on tax form that taxpayer would be "subject to monetary penalties" for failing to pay taxes meant that she would be only civilly liable), *cert. denied*, 495 U.S. 920 (1990); State v. Groves, 644 P.2d 1013 (Kan. Ct. App.) (holding that defendants could not rely on letter from Attorney General interpreting law when letter cautioned the defendant that the opinion carried no legal weight), *rev'd on other grounds*, 653 P.2d 457 (Kan. 1982); Green v. State, 785 S.W.2d 955 (Tex. Ct. App. 1990) (sustaining trial court's rejection of instructions on bail bondsman's proposed mistake of law defense based on reliance on United States Supreme Court case, since he could not produce copy of opinion upon which he relied, misstated the name of the case in testimony, and did not know the date of the opinion), *aff'd*, 829 S.W.2d 222 (Tex. Crim. App. 1992).

[356] People v. Bossert, 722 P.2d 998, 1008 (Colo. 1986).

one or more of the following."[357] The statute thus appears to attempt the impossible: to be simultaneously a mistake of law statute and a law that excuses conduct that was permitted anyway.

The New York Court of Appeals' ruling in *People v. Marrero*[358] is similarly hostile to any departure from the *ignorantia juris* principle. In that case, the court held that the defendant, a federal corrections officer, was not entitled to an instruction on New York's mistake of law statute based on his mistaken reliance on a New York statute exempting "peace officers" from the state's firearm possession statute.[359] Asserting that corrections officers are peace officers, the defendant claimed that the exemption statute reasonably led him to believe that he was entitled to carry a firearm.[360] The court ruled that the mistake of law statute was not intended to depart from the common law rule that ignorance of the law is no excuse, and that therefore the defense applies in only two situations. First, it applies where a mistake of law negates the requisite intent for a specific intent crime.[361] This exception to the general rule of *ignorantia juris* is well-recognized,[362] and in New York was available prior to the passage of the mistake of law statute.[363] Second, the statutory defense is available where, as in *Bossert*, "the misrelied-upon law has later been properly adjudicated as wrong."[364] The court so held even though New York's mistake of law statute does not contain the Model Penal Code's "afterward determined to be erroneous" language.[365] This robs the defense of all its meaning. As the dissent noted, "the construction leads to an anomaly: only a defendant who is *not mistaken* about the law when he acts has a mistake of law defense."[366]

Both the *Marrero* and the *Bossert* decisions are telling examples of the *ignorantia juris* principle's entrenchment in the law. These cases construe their states' mistake of law statutes without addressing the issue of due process. If they had, *Pennsylvania Industrial Chemical* would have compelled contrary

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[357] COLO. REV. STAT. ANN. § 18-1-504(2).
[358] 507 N.E.2d 1068 (N.Y. 1987).
[359] *Id.* at 1068.
[360] *Id.* at 1069.
[361] *Id.* at 1072.
[362] *See* Ryu & Silving, *supra* note 296, at 438–39.
[363] *See* People v. Weiss, 12 N.E.2d 514 (N.Y. 1938).
[364] *Marrero*, 507 N.E.2d at 1072.
[365] *Id.* at 1070–71.
[366] *Id.* at 1077 (Hancock, J., dissenting).

reasoning. In *Pennsylvania Industrial Chemical*, the Court held that the governmental statement relied upon by the defendant need not be erroneous to fall within the *Raley/Cox* doctrine, but only misleading in that it results in the defendant erroneously interpreting the law.[367]

Reflecting a view that *ignorantia juris* is more valid where criminal conduct also is thought to be immoral, the Supreme Court of North Dakota has held that its mistake statute does not apply to "blatantly offensive" conduct.[368] This court has also held that the mistake of law statute is not applicable to purely regulatory, strict liability offenses such as motor vehicle license laws.[369] Thus a defendant seeking to claim the defense must maneuver between these poles, making sure that the offense of which he is accused requires some culpability, but not so much that his conduct can be called "blatantly offensive." The conduct of parents relying on a prayer-exemption statute seems to avoid these two pitfalls: manslaughter does have a scienter requirement, but the conduct of such parents, who typically act in what they believe is the best interest of the child, cannot be called "blatantly offensive."

IV. Conclusion

Manslaughter prosecutions of parents who rely on prayer exemptions to child abuse and neglect laws raise serious due process notice and reliance problems, although the issue does not fit neatly into either the vagueness doctrine or the *Raley/Cox* reliance doctrine. The question of the validity of the prosecutions is at the intersection of these two loose doctrinal categories. The fundamental concepts of notice and fairness underlying both categories make these prosecutions constitutionally intolerable.

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[367] United States v. Pennsylvania Indus. Chem. Corp., 411 U.S. 655 (1973); *see also supra* notes 329–330 and accompanying text.

[368] State v. Lang, 378 N.W.2d 205, 209 n.7 (N.D. 1985) (rejecting mistake of law defense by defendant who intentionally damaged electric transmission tower on his property); State v. Patten, 353 N.W.2d 30 (N.D. 1984) (holding that defendant who abducted his children from estranged wife using techniques learned in book entitled "Divorce Dirty Tricks" could not claim mistake of law defense).

[369] State v. Fridley, 335 N.W.2d 785 (N.D. 1983) (rejecting defendant's assertion that he believed, based on a telephone conversation with someone at the Driver's License Division, that he could drive to work with a suspended license while waiting for a special work permit to be processed).

The prayer exemptions are facially simple and straightforward. They are accessible to citizens who try to ascertain the law, and are well-known to Christian Scientists. They therefore lull through narrow and precise language in the way that *Bouie* forbids. The confusion of a parent who reads a prayer exemption and a manslaughter statute also resembles the problem identified in *Cardiff* and related cases involving contradictory commands in statutory schemes. Furthermore, the factors for heightened vagueness review are present: an important underlying value at stake, a criminal statute, criminalization of an act of omission, and an implication of non-economic activity.

Yet as the discussion of the *Raley/Cox* doctrine has shown, more is going on in the prayer-treatment exemption/manslaughter cases than just confusion created by the government's poor drafting, as in the standard vagueness situation. The prayer exemptions, to varying degrees depending on their particular language, establish prayer treatment as a permissible alternative to allopathic medicine. The exemptions thus set many parents on a course of spiritual treatment of their children with the belief that their actions are lawful. Parents who have embarked on a course of lawful spiritual treatment are given no guidance as to the point at which a reasonable parent, under the manslaughter statutes, would seek medical treatment. In order to avoid vagueness problems, it seems that there should be an appropriately high standard of notice to parents of the point at which the prayer exemption runs out and manslaughter liability begins. The need for statutory clarity is at its greatest in situations where the government, through an affirmative act, leads an individual to believe that a certain type of conduct is legal, yet also seeks to limit this particular type of conduct. The existing prayer exemptions lack such clarity, with the possible exception of Oklahoma's exemption, as discussed below. As the Supreme Court's decision in *Pennsylvania Industrial Chemical* shows, the things that a statute omits can create a due process defense for someone who reasonably, though erroneously, believes that the things that the statute does say are all that need concern him.

The *McKown* court thus appears to have reached the correct result. From a pragmatic perspective, however, the contrary result of the trial court in *Twitchell* is not completely intolerable. The Twitchells were sentenced to ten years probation and a requirement that they seek medical attention for their three

children when they are ill.[370] This relatively lenient sentence suggests that the judge recognized the parents' good faith and the inappropriateness of a harsher punishment. However appealing such ad hoc compromises may be, proper fidelity to the Constitution requires that manslaughter prosecutions like *Twitchell* be overturned. There is no guarantee that other judges will be as lenient as the judge in *Twitchell.* More fundamentally, by tolerating such misleading and vagueness, our courts feed the notion that the government may act upon the citizenry through the cold mechanics of the law without regard for the individuals whom the law ultimately is meant to serve. This undermines both the rule of law and people's respect for it.

Rulings that the manslaughter prosecution of parents who rely on prayer-treatment exemptions were unconstitutional probably would force action by state legislatures. Nathan Talbot, a spokesman for the First Church of Christ, Scientist, stated in reaction to the Supreme Court's denial of certiorari in *McKown* that "[w]hat the decision says is, let's sort this out in the legislatures."[371] In light of the national campaign by the American Pediatrics Society for the repeal of the exemptions,[372] this is a likely result.

In *Bouie*, the Supreme Court noted that the due process notice problem with judicial expansion of a narrow and precise statute exists only for the first defendant who is brought before the law: the first prosecution puts subsequent defendants on notice.[373] It is unclear whether this concept would apply to the prayer-treatment exemption/manslaughter cases. While they share with *Bouie* the notion of reliance on narrow and precise statutory language, the due process problem is not limited to that outlined in *Bouie.* The *Raley/Cox* doctrine contains no such limiting provision, and thus there may be a continuing reliance problem for parents who undertake prayer treatment at the invitation of the prayer exemption provided by the government in the child abuse and neglect statutes. Because of the confusion caused by the two interlocking doctrines, the cleanest solution is to turn to legislative options.

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[370] Don Colburn, *In Seven Cases, Five Convictions*, WASH. POST, Sept. 25, 1990, at 17 (Health Supplement).

[371] Cullen, *supra* note 1, at 3.

[372] *See* Margolick, *supra* note 16, at A1.

[373] *See* Bouie v. City of Columbia, 378 U.S. 347, 362 (1964).

Oklahoma's solution of explicitly withdrawing the exemption "where permanent physical damage could result to such a child"[374] seems to be a step in the right direction. This clause, immediately following the prayer exemption, indicates to those who consult the statute that the exemption is not unlimited. There is still the problem that parents using prayer treatment will not recognize the point at which their child is threatened with permanent physical damage, but Oklahoma's caveat does at least let parents know that there is a risk involved in undertaking prayer treatment for their minor children. While the Oklahoma solution to the notice problem still leaves the parents in a precarious position and is an uneasy accommodation of religion, it nonetheless seems to satisfy the due process problem and may be the best legislative solution.

Other legislative options are available. Total repeal of the child abuse and neglect prayer-treatment exemptions would of course solve any notice problems for manslaughter prosecutions and would not violate the Free Exercise Clause. Yet it seems unduly harsh to criminalize prayer treatment in all circumstances. For example, with a disease where medical treatment is more art than science, such as elusive chronic ailments like migraine headaches, do we really want to foreclose all other options that parents might consider? Furthermore, criminalizing all prayer treatment seems too great an invasion of religious liberty. On the other hand, extending the exemption to encompass manslaughter would remove from the protection of the state children who, while born into a certain faith, have not yet made the decision as adults to pursue that faith. An intermediate option is to allow spiritual treatment as a defense to both child neglect and manslaughter, but to require parents to notify the child welfare authorities when a child has an illness of a certain degree of severity, and to allow intervention if appropriate.[375]

Whatever legislative options may be considered and adopted, the current situation cannot stand. Due process requires that legislatures be clear in establishing criminal penalties and that the government not punish those whom it has misled. Anything less is unworthy of a nation that prides itself on the rule of law and the rights of the individual.

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[374] *See* OKLA. STAT. tit. 21, § 852(A).

[375] *See supra* notes 53–55 and accompanying text.

NOTE

CONTINGENT VALUE RIGHTS AND THE TAXATION OF CONTINGENT PAYMENT OBLIGATIONS

CAROLYN M. ZANDER*

Although significant efforts have been made within the tax system throughout the past decade to increase recognition of the time value of money and the taxation of true economic interest, the system has failed to address these issues in the field of contingent payment obligations.

In this Note, Ms. Zander analyzes the inconsistencies in the current system's approach to taxing contingent payment obligations and discusses the problems involved in the timing of income recognition and the characterization of income. She then suggests how a different approach to the taxation of contingent payment obligations might help to resolve some of these problems and inconsistencies.

A contingent payment obligation is a financial instrument with a return that cannot be measured until the resolution of the contingency at some point in the future. When the contingency is resolved in the same year in which the instrument is purchased, income can easily be measured and taxed. When the obligation matures in a year subsequent to the year in which the instrument is purchased, however, two important problems regarding the taxation of the instrument are raised.

The first problem is whether the tax system should take account of the time value of money invested in the contingent payment obligation, and if so, what approach it should take. The system has made great strides in the last decade to recognize the time value of money. Perhaps the best evidence of progress in this area is the original issue discount ("OID") provisions.[1] In general, these rules and regulations attempt to tax the holder of a debt instrument on the instrument's real economic interest as the interest accrues, regardless of what interest the instrument purports to pay. The progress, however, has been

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* Associate, King & Spalding, Atlanta, Ga. A.B., Duke University, 1989; J.D., Harvard Law School, 1992. The views expressed herein are solely those of the author and do not necessarily represent the views of King & Spalding or any other attorneys at the firm. The author would like to thank Professor Alvin Warren, Robert Scarborough, Esq., and the students in the Spring 1992 Taxation Seminar: New Financial Products at Harvard Law School for their helpful comments and suggestions.

[1] *See generally* I.R.C. §§ 1271–1275 (1988); Prop. Treas. Reg. § 1.1271-1 to .1275-5, 51 Fed. Reg. 12,022–95 (1986).

made mostly in the area of fixed payment obligations, not in the area of contingent payment obligations.[2]

The second problem is whether any income from a contingent payment instrument held for more than one year should be considered long-term capital gain and subject to preferential tax treatment. This problem is actually one facet of a broader question regarding whether gain and loss from a contingent payment obligation should be treated as capital or ordinary. The characterization of income from contingent payment obligations under the current system varies widely from entirely capital to entirely ordinary, with numerous compromises between the two extremes.

The current system resolves both problems inconsistently and often incorrectly. Although the tax system generally should strive for correct and consistent tax treatment, reaching these goals has become particularly important given the number of new contingent payment products entering the market designed to take advantage of these problems. Developing a new approach to the taxation of contingent payment obligations that minimizes inconsistent treatment between products and more accurately accounts for the real changes in the taxpayer's net worth is perhaps the only way to stop erosion of our tax base.

The purpose of this Note is to explore the current system's approach to taxing contingent payment obligations and then to offer suggestions to improve the system. I begin with an analysis of the contingent value right ("CVR"), a contingent payment obligation issued with some frequency in mergers and acquisitions. In Part I, I explain the fundamentals of the CVR. In Part II, I discuss the market roles that the CVR can play, not only in mergers and acquisitions, but also in recapitalizations, takeover defenses, and bankruptcy plans.

I then focus on the tax issues raised by contingent payment obligations. In Part III, I introduce these issues by analyzing how the current system taxes the CVR; in particular, I explore the debate over whether the instrument should be treated as debt or as a cash settlement put option and why the characterization matters. In Part IV, I explain how the tax system has taken a number of inconsistent approaches to the taxation of contingent payment obligations in addition to the potential tax

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[2] Stephen B. Land, *Contingent Payments and the Time Value of Money*, 40 TAX LAW. 237, 237 (1987).

treatments for CVRs. I also discuss the problems that these inconsistencies create for the system. In Part V, I discuss the problems with the current system's approach to contingent payment obligations regarding the timing of income recognition and the characterization of income. I then suggest better approaches to the taxation of contingent payment obligations. Finally, in Part VI, I offer concluding remarks.

I. The Fundamentals of the Contingent Value Right

The term contingent value right covers a range of contingent payment obligations; each new issue has slightly different characteristics. In this Part, I describe the CVR in its basic form as well as some common variations. In general, the CVR guarantees that at some point in the future (the maturity date), a particular stock will be trading above a specific target price (the strike price). If the share price is below the strike price on the maturity date, the holder of the CVR is entitled to receive the difference in value between the strike price and the actual share price on that date. Consequently, the value of the CVR varies inversely with the value of the underlying stock. If the share price rises above the strike price, the CVR is worthless; as the share price falls below the strike price, the value of the CVR increases.

The CVRs are usually issued to a subset of shareholders of the corporation upon whose value the CVRs depend. For example, in change-of-control transactions, CVRs have been issued to the remaining minority shareholders;[3] in a recapitalization, CVRs have been issued as part of an investment unit that includes a share of stock for each CVR.[4] Although CVRs are initially owned by shareholders, they are sometimes traded separately from the stock;[5] in fact, several CVRs have been listed

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[3] *See, e.g.*, The Dow Chemical Company Prospectus for Contingent Value Rights 46 (Oct. 30, 1989) [hereinafter Dow Prospectus]; Rhône-Poulenc S.A. Prospectus For Contingent Value Rights 8 (Mar. 22, 1990) [hereinafter Rhône-Poulenc Prospectus].

The Dow Chemical CVR was issued in Dow Chemical's acquisition of Marion Laboratories. The Rhône-Poulenc CVR was issued in Rhône-Poulenc S.A.'s acquisition of Rorer Group.

[4] *See, e.g.*, Rev. Rul. 88-31, 1988-1 C.B. 302.

[5] *See, e.g.*, Dow Prospectus, *supra* note 3, at 2; Rhône-Poulenc Prospectus, *supra* note 3, at 8.

on national securities exchanges.[6] Consequently, someone could easily hold either the share or the CVR without holding the other instrument.

The following example illustrates how the CVR works:

After a successful tender offer for 50% of Target, Inc. at $100 per share, Acquirer, Inc. merges a subsidiary into Target. In exchange for additional shares of Target, Acquirer issues CVRs to the minority shareholders of Target on Jan. 1, 1992. The CVR guarantees that on Jan. 1, 1994, the holder will receive a cash payment equal to the excess of $121 (the tender offer price of $100, plus a 10% compound interest rate) over the actual share price of Target on that date. If the share price of Target on Jan. 1, 1994, equals or exceeds $121, the CVR holder receives nothing. If the share price is $100, Acquirer will pay $21 per CVR.

This basic version of the CVR can be modified in a number of ways. First, issuers sometimes limit the CVR payment by setting a "floor" on how low the actual share price can fall for purposes of computing the CVR payment.[7] In the above example, if Acquirer set a floor price of $80, the CVR holder would be guaranteed to receive the excess of $121 over the greater of (1) the actual market price on Jan. 1, 1994, and (2) $80. Whether the shares trade at $80 or $1 on Jan. 1, 1994, Acquirer would only have to pay $41 per CVR.

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[6] The American Stock Exchange listed the Dow Chemical CVR, *see AMEX Starts Trading Dow Chemical Rights*, Reuters, Nov. 7, 1989, *available in* LEXIS, Nexis Library, Omni File, and the Rhône Poulenc CVR. *See Rhône-Poulenc S.A. Lists Contingent Value Rights on American Stock Exchange*, PR Newswire, Aug. 9, 1990, *available in* WESTLAW, PRNews File.

The New York Stock Exchange listed the Brooke Group CVR. *See* Melissa Goldblatt, *Brooke Group Restructuring Prompts Fluctuating Prices*, BUSINESS DATELINE, Sept. 30, 1991, at 16. The Brooke Group CVR was issued in Brooke Group's acquisition of its former parent, Brooke Partners, L.P.

[7] *See, e.g.*, DOW PROSPECTUS, *supra* note 3, at 46, 50, 51 (CVR with strike price of $45.77 had a floor price of $30); RHÔNE-POULENC PROSPECTUS, *supra* note 3, at 8 (CVR with strike price of $98.26 had a floor price of $52).

Several recent issues of CVRs have not set a ceiling on the CVR payment. These CVRs include the Signal Apparel CVR (issued in the Signal Apparel acquisition of Shirt Shed Inc.), *see Signal Apparel Company Inc. and the Shirt Shed Inc. Announce Commencement of Joint Proxy Solicitation*, Business Wire, June 19, 1991, *available in* WESTLAW, Buswire File [hereinafter *Signal Apparel Proxy Solicitation*], and the Brooke Group CVR. *See Brooke Group Ltd. Completes Restructuring*, PR Newswire, Nov. 19, 1990, *available in* WESTLAW, PRNews File. Similarly, the CVR in the proposed merger between LIVE Entertainment and Carolco Pictures also did not limit the CVR payment; the merger subsequently fell through. *See Board of Carolco Pictures Approves Terms of Merger with LIVE Entertainment*, Business Wire, Nov. 19, 1991, *available in* WESTLAW, Buswire File [hereinafter *Board of Carolco Pictures*].

Second, although the payment is typically made in cash, some CVRs are paid off in the underlying stock,[8] in other securities, or in a combination of securities and cash.[9]

Third, although the triggering event for CVR payments is often the expiration of a fixed time period, the payments can also be triggered by a subsequent change-of-control transaction, such as the sale of the target company, or substantially all of its assets, to a third party.[10]

Fourth, although most CVR payments have been tied to the share price of a particular stock, at least one CVR payment has been conditioned essentially on the amount of profit turned by the acquirer on a subsequent sale of the target corporation.[11] The CVR payment could also be conditioned on the target corporation's profitability rather than its share price.[12]

For purposes of this Note, the CVR will have the following characteristics, except when otherwise stated: (1) the CVR will be publicly traded on a national securities exchange; (2) the CVR will have a floor price; (3) the CVR will settle in cash; (4) the CVR payment will be triggered solely by the expiration of a fixed time period; and (5) the CVR will be contingent on the market value of one particular stock.

II. The Market Role of the CVR

CVR issuers have been drawn to this financial instrument because it can reduce the risk associated with holding a share of stock. Because the value of the CVR varies inversely with the value of stock, a decline in the share price of stock is offset

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[8] For example, the Signal Apparel CVR was to be settled in Signal Apparel common stock. *See Signal Apparel Proxy Solicitation*, *supra* note 7.

[9] The LIVE CVR would have settled in "either cash, securities, or some combination of both." Patrice Apodaca, *Carolco Drops Merger Talks With Live Entertainment*, L.A. Times, Dec. 4, 1991, at D2.

[10] *See, e.g.*, Dow Prospectus, *supra* note 3, at 47, 50 (CVR payments triggered by "merger, consolidation or other business combination" or "sale, transfer or other disposition of all or substantially all of the assets").

[11] In its acquisition of Permian Partners, National Intergroup Inc. issued a CVR contingent on the profit it would make on a subsequent sale of Permian Partners, L.P. *See NII: Partial Settlement Reached*, PR Newswire, July 9, 1990, *available in* WESTLAW, News-ASAP File.

[12] In the WestAir Holding/Mesa Airlines merger, a CVR based on Mesa's 1992 profitability was proposed. *See WestAir and Mesa Reach Definitive Agreement on Merger*, Business Wire, Jan. 13, 1992, *available in* LEXIS, Nexis Library, Omni File. The merger was subsequently completed without the CVR. *See Mesa, Westair Reach Final Agreement on Merger*, Business Wire, Jan. 20, 1992, *available in* LEXIS, Nexis Library, Omni File.

by an increase in the value of the CVR and ultimately the CVR payment; by holding a CVR for each share of stock, shareholders are not exposed to the downside risk associated with the stock.[13]

The risk-reduction feature of the CVR can be utilized in four contexts. First, and most often, CVRs are issued in mergers and acquisitions. Second, CVRs can be issued in recapitalizations. Third, it has been suggested that the CVR be used as a takeover defense against hostile acquisitions. Fourth, the CVR could be part of a Chapter 11 bankruptcy plan of reorganization. In this Part, I explore each market role for the CVR.

A. *Mergers and Acquisitions*

The CVR has been issued almost exclusively in the context of mergers and acquisitions. Acquirers find the CVR particularly attractive because they can reduce the cost of purchasing an initial control block in the target corporation by issuing CVRs.[14] In general, minority shares are worth less after the takeover because these shares lose their voting power once the acquirer gains control of the target. Consequently, unless the acquirer tenders for 100% of the target's shares, a rational shareholder of the target corporation considering whether the tender offer price is fair should evaluate the weighted average of the tender offer price and the estimated value of his minority shares after the tender offer.

By issuing a CVR for each minority share remaining after a takeover, the acquirer can guarantee that each minority share

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[13] The protection against decline in share price is limited in two ways. First, by setting a floor price on the CVR, issuers frequently limit how large the CVR payment can become. Shareholders are at risk for any further decline in the share price once the CVR payment reaches the maximum limit. *See supra* note 7 and accompanying text.

Second, the guarantee is only as credible as the issuer is financially strong. *See* Simon London, *Shielding Investors from Predators*, FIN. TIMES, May 14, 1991, at 29. If the CVR issuer is not financially sound, CVR holders run the risk that the issuer could go bankrupt, especially if a large CVR payout is required at the instrument's maturity. The CVR holder could be in the unfortunate position of an unsecured creditor, in which case the chances of receiving any payment are small. The Dow Chemical CVR holders, for example, were unsecured creditors. DOW PROSPECTUS, *supra* note 3, at 46. In contrast, the Brooke Group CVRs were secured. *See Bennett LeBow Puts Paid to Perils of Pauline for Western Union, MAI with Saucy Deal*, Computergram Int'l, Dec. 3, 1990, *available in* LEXIS, Nexis Library, Omni File.

[14] Philippe P. Dauman et al., *Developments in Mergers and Acquisitions: The Offense*, *in* 2 22D ANNUAL INST. ON SEC. REG. 9, 78 (PLI Corp. Law and Practice Course Handbook Series No. 713, 1990); *see also* Beth McGoldrick, *Contingent-Value Rights: Are They Debt or Put Options?*, INSTITUTIONAL INVESTOR, May 1990, at 161.

will have the same value at a future point in time as the shares sold in the tender offer.[15] Held with a share of stock, the CVR offsets any decline in share price, with the effect of practically locking in a future return. Guaranteed to receive equivalent value for their minority shares, shareholders should demand less of a premium for the shares they sell in the tender offer, thus decreasing the cost of purchasing an initial control block.[16]

If the acquirer is lucky, the share price of the target will exceed the strike price when the CVR matures and the acquirer will not have to make any additional payments.[17] If the acquirer is not so fortunate, the share price will be less than the strike price when the CVR matures and the acquirer will have to make CVR payments, thus increasing the overall costs of the takeover. The acquirer does not necessarily benefit from deferring the cash outlay to the CVR maturity date because the CVR strike price is usually equal to the future value of the tender offer price when the CVR matures.[18]

Acquirers have recognized the benefits of contingent payment obligations for years. In its 1984 acquisition of Electronic Data Systems, General Motors issued contingent promissory notes much like CVRs as a means to ensure that its Class E stock would be trading no lower than $125 seven years after it was issued.[19] The note essentially entitled the holder to one-fifth of the excess of $125 over the actual share price of Class E stock on the maturity date.[20] This note was generally not transferable and was issued only if the shareholder made an election to receive it.[21]

Eli Lilly also used a contingent payment obligation resembling a CVR when it acquired Company of Hybritech as a subsidiary in 1986. Each Hybritech shareholder received a combination of cash and securities, including a contingent payment unit issued

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[15] *See* Leonard J. Hollie, *Volatility Prompts Investors to Seek New Security*, PENSIONS & INVESTMENTS, Feb. 19, 1990, at 3.

[16] *See id.*; Robert McGough, *Dow's $1.5 Billion Chess Game*, FIN. WORLD, Nov. 13, 1990, at 24, 25.

[17] *See* Dauman et al., *supra* note 14, at 78.

[18] For example, the Dow Chemical CVR strike price was $45.77, which is the future value of the tender offer price, $38 per share, discounted at a rate of approximately 9.75%. DOW PROSPECTUS, *supra* note 3, at 51. This interest rate was comparable to interest rates for two-year notes issued in mid-1989. McGough, *supra* note 16, at 26.

[19] Douglas H. Walter & Paul A. Strasen, *General Motors Class E and Class H Common Stock*, 64 TAXES 365, 366 (1986).

[20] *Id.*

[21] *GM Acquires Electronic Data Systems*, PR Newswire, Aug. 14, 1984, *available in* LEXIS, Nexis Library, Omni File.

by Eli Lilly.[22] The contingent payment unit entitled the holder to receive annual cash payments over a ten-year period based on the subsidiary's sales and gross profits.[23] Unlike the General Motors contingent promissory note, this contingent payment unit was separately tradeable and was listed on the American Stock Exchange.[24]

Contingent payment obligations achieved new fame in 1989 when Dow Chemical Company ("Dow Chemical") introduced the CVR in its acquisition of Marion Laboratories ("Marion").[25] Rhône-Poulenc S.A. quickly followed Dow Chemical's lead and issued CVRs in its acquisition of Rorer Group in 1990.[26] In both acquisitions, the acquirer issued the CVR as part of an overall plan designed to minimize the goodwill from the transaction by qualifying the merger for "transfer under common control" accounting treatment.

When two corporations under common control are merged, the accounting treatment is similar to a pooling of interests[27] in which the two corporations combine their balance sheets at historical cost.[28] When the pooling-of-interests method of accounting does not apply, the newly acquired assets must be listed on the balance sheet at their fair market value, and the difference between the old book value and fair market value must be recorded as goodwill.[29] Acquirers are anxious to minimize goodwill because it must be "amortized over a period not exceeding 40 years, and the periodic amortization charges have to be deducted from reported income."[30] The minimization of goodwill makes corporate earnings and profitability appear as high as possible.[31]

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[22] Douglas H. Walter & Paul A. Strasen, *Eli Lilly Acquisition of Hybritech—Contingent Payment Units*, 64 TAXES 488, 489 (1986).
[23] *Id.*
[24] *See id.*
[25] *See* Hollie, *supra* note 15, at 3.
[26] *See id.*
[27] *See* Robert H. Herz & Edward J. Abahoonie, *Innovations to Minimize Acquisition Goodwill*, MERGERS & ACQUISITIONS, Mar.–Apr. 1990, at 35, 36.
[28] *See* RICHARD BREALEY & STEWART MYERS, PRINCIPLES OF CORPORATE FINANCE 719 (2d ed. 1984).
[29] *Id.* at 720.
[30] *Id.*
[31] Herz & Abahoonie, *supra* note 27, at 36.

If markets are efficient, the accounting treatment of the acquisition should not effect the true market value of the corporation. Regardless of the amount of amortized goodwill, the corporation has the same cash flow.

The market, however, apparently responds to the accounting definition of the corporation's earnings, which motivates management to minimize goodwill. Lecture by

Dow Chemical's takeover of Marion was executed in two steps. In step one, Dow Chemical successfully tendered for approximately 39% of Marion's outstanding shares.[32] Combined with Dow Chemical's lockup on voting proxies for an additional 13% of Marion shares, the shares acquired in the tender offer gave Dow Chemical control over Marion.[33]

In step two, Dow Chemical voted its 52% of Marion shares in favor of merging Marion with Dow Chemical's wholly owned subsidiary, Merrell Dow Pharmaceuticals ("Merrell Dow"). In the merger, Dow transferred to Marion all of its Merrell Dow shares and one CVR for each minority share remaining after the takeover; the CVRs were subsequently distributed to the minority shareholders.[34] In exchange, Dow Chemical received additional shares of the new corporation, Marion Merrell Dow, Inc., increasing its ownership to 67%.[35]

By dividing the acquisition into two steps, Dow Chemical overcame its biggest obstacle to qualifying the merger for the "pooling-like" accounting treatment. The pooling-of-interests method of accounting was available to Dow Chemical only if Marion and Merrell Dow were both under Dow Chemical's control.[36] Before the tender offer, Dow Chemical held no Marion shares, although it did own 100% of Merrell Dow. Step one of the transaction put Dow Chemical in control of Marion so that in step two of the transaction, Merrell Dow and Marion were under common control, and the merger could be treated like a pooling-of-interests for accounting purposes.[37]

Had Dow Chemical purchased a 67% interest in Marion outright, its goodwill under the normal purchase method of accounting would have been the excess of the fair market value of the 67% interest in Marion over 67% of the net book value of Marion.[38] However, because the transaction was treated like a pooling-of-interests, Dow Chemical recognized much less goodwill. Specifically, Dow Chemical's goodwill was the excess

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Robert Willens, Senior Vice President of Lehman Brothers, Taxation Seminar: New Financial Products, Harvard Law School, April 29, 1992.

[32] *See* Dow PROSPECTUS, *supra* note 3, at 1.

[33] *Id.* at 2.

[34] *Id.*

[35] *Id.*

[36] *See* Herz & Abahoonie, *supra* note 27, at 38.

[37] *Id.*

[38] *See* Ray H. Johnson, *Recent Accounting Developments and Trends in the Acquisitions and Mergers Area, in* 1 ACQUISITIONS & MERGERS IN A CHANGING ENVIRONMENT 35, 45 (PLI Corp. Law and Practice Course Handbook Series No. 699, 1990).

of the amount paid for its 39% block of Marion shares, plus 33% of Merrell Dow's book value,[39] plus the fair market value of the CVRs over 67% of Marion's net book value.[40]

Dow Chemical avoided the write-up of goodwill because instead of valuing the entire 67% interest in Marion at fair market value, only a 39% interest in Marion[41] and the CVRs were valued at fair market value. The remainder of Dow Chemical's interest in Marion was received in exchange for 33% of Merrell Dow stock, which could be valued at book value under the pooling-of-interests treatment. Because the book value of the Merrell Dow shares was considerably lower than their fair market value, Dow Chemical significantly reduced the amount of goodwill generated by the transaction; some estimates put the savings in goodwill at $5–6 billion.[42] Even if Dow Chemical amortizes the goodwill over forty years, its earnings are $125–150 million higher per year because of the accounting treatment utilized in this merger.[43]

The CVRs played an important role in the reduction of goodwill by enabling Dow Chemical to minimize the cost of purchasing its initial control block in Marion. Because it had to recognize goodwill on the shares it purchased for cash in the tender offer, Dow Chemical's incentive was to purchase the minimum number of shares necessary to gain control of Marion at the minimum price necessary to acquire those shares.

Without the CVRs, minority shareholders would have required a higher premium for the shares tendered in the first step of the transaction because the shares they continued to hold after the merger would decline significantly in value. By issuing

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[39] Because Dow Chemical owned 67% of the merged corporation after the transfer, it effectively gave up only a 33% interest in Merrell Dow.

[40] *See* Herz & Abahoonie, *supra* note 27, at 38.

[41] The purchase method of accounting, requiring the write-up of goodwill, applied to the 39% interest purchased in the tender offer for cash.

[42] *See* Johnson, *supra* note 38, at 45–46 (estimating the reduction in goodwill at $5.9 billion); Beth McGoldrick, *The Quashing of Dow's Merger Experiment*, INSTITUTIONAL INVESTOR, Oct. 1990, at 299 (estimating the reduction in goodwill at $5.3 billion). Robert Willens suggested that the reduction in goodwill was closer to $900 million. Lecture by Robert Willens, *supra* note 31.

[43] By limiting its ownership of Marion to a 67% interest, Dow Chemical also managed to keep all the goodwill on its balance sheet and not on the balance sheet of Marion Merrell Dow. Robert J. Cole, *Wall St. Invents Painless Mergers*, N.Y. TIMES, Sept. 18, 1989, at D6. If Dow Chemical had acquired substantially all of Marion, defined as approximately 90%, then the goodwill would have been "pushed down" from Dow Chemical's balance sheet to the balance sheet of the subsidiary. *Id.* In this case, Marion Merrell Dow's only goodwill was the $126 million of goodwill carried over from Merrell Dow's balance sheet. *See* Herz & Abahoonie, *supra* note 27, at 38.

a CVR for every minority share, Dow Chemical could guarantee that minority shares would be worth at least as much as the shares sold in the tender offer;[44] consequently, Dow Chemical could lower its offer in the first step of the acquisition.[45]

Although the SEC approved the treatment of goodwill in this transaction,[46] and in Rhône-Poulenc S.A.'s acquisition of Rorer Group,[47] the SEC has since reversed its position on the proper accounting treatment for this transaction, following a ruling by the Emerging Issues Task Force.[48] The Task Force decided that looking at the transaction as a whole, the two-step acquisition was in substance just one transaction in which two corporations not under common control were merged.[49] Consequently, acquisitions structured like the Dow Chemical/Marion takeover can no longer be treated like a pooling of interests because the acquirer does not control the target when the takeover begins.

Although CVRs can no longer be used to avoid recognizing goodwill, they continue to be issued in mergers and acquisitions.[50] Minimizing the expense of purchasing an initial control block is particularly important today because the financing so readily available in the 1980s has become more scarce.[51] The flexibility of using CVRs instead of cash to finance an acquisition

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[44] *See* Dauman et al., *supra* note 14, at 78; McGough, *supra* note 16, at 24. Note, however, that this guarantee was limited because shareholders were at risk for any decline in share value below $30, the CVR's floor price. *See supra* note 13.

[45] *See* Dauman et al., *supra* note 14, at 78.

[46] Stephen Fraidin & Daniel R. Mitz, *New Deal Structures in the 1990's*, *in* 2 22D ANNUAL INST. ON SEC. REG. 273, 304 (PLI Corp. Law and Practice Course Handbook Series No. 713, 1990); McGoldrick, *supra* note 42, at 299.

[47] McGoldrick, *supra* note 42, at 299.

[48] *See* Fraidin & Mitz, *supra* note 46, at 305.

[49] *Id.*; McGoldrick, *supra* note 42, at 299.

[50] For example, CVRs were issued in Signal Apparel's acquisition of Shirt Shed, *see Signal Apparel Proxy Solicitation*, *supra* note 7, National Intergroup's acquisition of Permian Partners, *see NII: Partial Settlement Reached*, *supra* note 11, and Brooke Group's acquisition of its former parent, Brooke Partners. *See Brooke Group Ltd. Completes Restructuring*, *supra* note 7. The CVR was also part of the proposed, but scrapped, merger between LIVE Entertainment and Carolco Pictures. *See Board of Carolco Pictures*, *supra* note 7.

Most recently, a CVR has been proposed in the potential merger between Westair Holding and Mesa Airlines. *See WestAir and Mesa Reach Agreement in Principle*, Business Wire, Nov. 18, 1991, *available in* WESTLAW, Buswire File.

Robert Willens, however, suggests that the days of CVRs in major mergers and acquisitions ended with the Emerging Issues Task Force ruling denying pooling-of-interests accounting treatment for acquisitions structured like the Dow Chemical/Marion deal. Lecture by Robert Willens, *supra* note 31.

[51] Fraidin & Mitz, *supra* note 46, at 305; *Companies Turn to Unconventional M&A Techniques*, CORP. FINANCING WK., Apr. 9, 1990, at 1.

should appeal to issuers.[52] Even if financing was more readily available, highly leveraged buyouts financed by junk bonds have recently received such negative publicity that acquirers may be attracted to the CVR as a way to avoid the junk bond stigma.[53]

B. *Recapitalizations*

Although most issues of CVRs have been limited to the acquisitions area, CVRs can also be used in a recapitalization. Specifically, when raising capital through the issuance of new shares, a corporation could increase the attractiveness of the investment by attaching a CVR to each new share. Investors would be guaranteed to receive a specific return on the stock/CVR unit because on the CVR's maturity date, either the stock will be trading above the strike price or the CVR payment will compensate the shareholder for the difference in value.

In 1986, Conquest Exploration Company sold investment units comprised of a share of stock and a contingent payment right much like the CVR in an effort to raise new capital.[54] Revenue Ruling 88-31,[55] which discusses how contingent payment rights should be taxed, is based upon the right issued by Conquest Exploration.

C. *Takeover Defenses*

When AT&T made a hostile bid for NCR in late 1990, the Wall Street Journal reported that NCR was considering using the CVR as a takeover defense.[56] As an alternative to the tender offer, the NCR management could have offered to distribute one CVR for each outstanding share. The CVRs would have guar-

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[52] Hollie, *supra* note 15, at 3. Apparently, a limited budget was one factor that made CVRs attractive to Dow Chemical in its acquisition of Marion. According to its president, Dow Chemical could not have gone beyond a $2.2 billion cash outlay, or $38 per share, for the Marion shares purchased in the tender offer. McGough, *supra* note 16, at 26. The Marion shareholders originally wanted more than $40 per share in the tender offer, but were willing to settle for $38 per share in exchange for receiving the CVRs. *Id.*

[53] *See generally* Johnson, *supra* note 38, at 35.

[54] *See* CONQUEST EXPLORATION COMPANY PROSPECTUS 28 (July 30, 1986).

[55] Rev. Rul. 88-31, 1988-1 C.B. 302.

[56] *See* Randall Smith, *NCR Weighs Using Untested Rights Design*, WALL ST. J., Jan. 10, 1991, at A7. In fact, there are reports that contingent payment obligations have been used as takeover defenses in the past. *See Companies Turn to Unconventional M&A Techniques*, *supra* note 51, at 1.

anteed that the share price of the target corporation would trade above the acquirer's offer at a future point in time.

Issuing CVRs in this context, however, is a risky proposition for the CVR issuer because it must guarantee such a high strike price. In addition to guaranteeing the tender offer price, which includes a premium for the control block, management would have to offer a sufficiently attractive return over the lifetime of the CVR to lure shareholders away from the acquirer's offer.[57] The target corporation would probably have to leverage itself significantly to make the CVR payments on maturity.[58] If the CVR issuer could not borrow sufficient funds to make the payments, or could not pay the interest on such borrowings as it came due, the issuer would face bankruptcy.

The CVR has a more fundamental problem, though, as a takeover defense. To use the CVR as a takeover defense, the target corporation must issue a CVR based on its own stock for each outstanding share. Ultimately, any CVR payment would come either from the corporation's current assets or from its future earnings, assuming that the corporation borrowed the funds for the CVR payments and repaid the loan with interest over time. In either case, the value used to compensate the shareholders through the CVR payment is value that the shareholders would own anyway if the CVR payments were not made. No shareholder is better off by receiving the CVR payment because the CVR payment creates a corresponding loss of value on each share of stock.

Shareholders only benefit from the CVR when the CVR payments are funded either by a shift of value between shareholders or by shifting value into the corporation from an outside source. If the target corporation issued the CVR only to a subset of its shareholders, the CVR payment would still depress the corporation's earnings; however, because some of the loss would be borne by shareholders not holding the CVRs, shareholders holding CVRs would still benefit. When the CVR is issued by a third party, such as a parent corporation, the compensation for the CVR payment comes from an outside source and should not affect the target corporation's earnings or share price.

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[57] *See* Sarasue French, *Street Says CVRs Aren't for the Likes of NCR*, INVESTMENT DEALERS' DIG., Jan. 21, 1991, at 5.
[58] *Id.*

The only way that shareholders could benefit from the CVR issued as a takeover defense is if the target corporation recapitalized to finance the CVR payments. Unless the CVR provides shareholders with new value that they would not otherwise receive, the effectiveness of the CVR's guarantee of a future trading price for the stock is highly questionable.

D. *Chapter 11 Plan of Reorganization in Bankruptcy*

CVRs have recently been proposed as part of a Chapter 11 plan of reorganization in bankruptcy. Although LTV Corporation ("LTV") filed for bankruptcy over five years ago, it has been unsuccessful in getting its creditors to confirm a plan of reorganization, due in large part to the claims of one major creditor, Pension Benefit Guarantee Corporation ("PBGC").[59] On February 14, 1992, LTV filed a Chapter 11 plan of reorganization that involves CVRs.[60] Under the plan, PBGC would issue CVRs to other unsecured creditors who are receiving stock in the reorganized corporation; PBGC has promised to pay up to $96.25 million on the CVRs.[61] In exchange, PBGC would receive stock appreciation rights, which would entitle PBGC to receive more shares of the reorganized corporation if the stock is trading above a targeted price one year after the plan became effective.[62]

Plans are typically held up from confirmation because creditors disagree over the value of the reorganized firm and how well it will do in the future. By issuing CVRs and stock appreciation rights, creditors can take different positions on these issues. PBGC, in issuing the CVRs in exchange for stock appreciation rights, has obviously taken an optimistic view about how well LTV will perform; it is willing to bear a larger share of the downside risk in exchange for greater participation in the profits if LTV succeeds. The creditors receiving CVRs while issuing stock appreciation rights have insulated themselves from some of the risk that LTV will not succeed, at the expense of giving up some of the upside returns if the corporation does perform well.

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[59] *LTV Files Modified Chapter 11 Plan of Reorganization*, Business Wire, Feb. 14, 1992, *available in* LEXIS, Nexis Library, Omni File.

[60] *Id.*

[61] *Id.*

[62] *Id.*

III. Taxation of CVRs Under the Current System

The current debate over how to tax the contingent value right has centered around whether it should be treated as a debt instrument or as a cash settlement put option. In this Part, I explain and evaluate the arguments for characterizing the CVR as debt and as an option. I then discuss the tax consequences that follow from each characterization.

A. *Treatment of the CVR as a Debt Instrument*

1. Characterizing the CVR as Debt

For a number of years, the correct tax characterization of the CVR was assumed to be debt,[63] especially after the promulgation of the OID rules[64] in 1984 and the proposed OID regulations for contingent debt instruments in 1986.[65] In fact, the debate over how to tax the contingent promissory note issued by General Motors in its acquisition of Electronic Data Systems[66] centered around whether the obligation would receive imputed interest treatment or whether the obligation would instead fall within the new OID code sections.[67] Under the imputed interest approach, the contingent payment would be discounted to its present value in 1984, and the difference in the present value and future value would be treated as interest.[68] Under the OID rules, all amounts received in excess of the issue price would be interest.[69]

Issuers continue to take the position that the CVR should be treated as debt because the holder has a right to receive a deferred payment at a fixed point in time.[70] When the CVR is purchased from the issuer, the cash flow can be imagined as the CVR holder lending the purchase price to the issuer in exchange

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[63] General Motors was the first issuer to argue that its contingent promissory notes were debt. Interestingly, the OID provisions had just been enacted into law and none of the proposed regulations on contingent debt obligations had yet been written.

[64] I.R.C. §§ 1271–1275 (1988), *enacted by* Tax Reform Act of 1984, Pub. L. No. 98-369 §§ 41, 42, 44, 98 Stat. 494, 531 (1984).

[65] Prop. Treas. Reg. § 1.1275-4, 51 Fed. Reg. 12,022, 12,090 (1986).

[66] *See supra* notes 19–21 and accompanying text.

[67] Walter & Strasen, *supra* note 19, at 369.

[68] *Id.*

[69] *Id.*

[70] *See* Robert Willens, *Dow Will Redeem the CVRs*, Shearson Lehman Brothers: ASAP, Sept. 16, 1991.

for the contingent debt obligation. When the CVR is issued in an acquisition, the cash flow should be thought of in two steps. First, the corporation distributes a cash dividend to shareholders. Second, the shareholders lend the cash back to the corporation in exchange for the contingent debt instrument.

The expansive definition of debt under the OID provisions lends credibility to the argument that CVRs are debt instruments. A debt instrument is defined as all "evidence of indebtedness,"[71] not just bonds and notes. In particular, "all rights to deferred payments under a contract, whether or not evidenced by a formal instrument," are included in the definition.[72] The existence of detailed regulations on how to tax partially and wholly contingent debt instruments[73] also supports the characterization of CVRs as debt.[74]

Relying on the OID provisions and regulations to characterize the CVR as debt is problematic, however, because it ignores a threshold requirement for qualifying an instrument for OID treatment. The OID rules explicitly state that before an instrument becomes indebtedness under the OID rules, it must first be "valid indebtedness under general principles of Federal income tax law."[75] Nothing in the OID definition of indebtedness is meant to expand the common law meaning of debt.

Unfortunately, the general principles of indebtedness are anything but clear. The Internal Revenue Code does not define debt. I.R.C. § 385 sets forth a tentative list of factors that could be considered as evidence of indebtedness, but the decision of how to distinguish between debt and equity is left up to the U.S. Treasury Department (the "Treasury"). The Treasury proposed regulations under section 385 in 1980[76] but withdrew them in 1983.[77] Thus, section 385 provides no real guidance on this issue.

To distinguish debt from equity, the common law has defined debt as "an unqualified obligation to pay a sum certain at a reasonably close fixed maturity date along with a fixed percentage in interest payable regardless of the debtor's income or lack thereof."[78] The more an instrument strays from this definition,

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[71] I.R.C. § 1275(a)(1)(A).
[72] Prop. Treas. Reg. § 1.1275-1(b)(1), 51 Fed. Reg. 12,022, 12,084 (1986).
[73] *Id.* § 1.1275-4.
[74] *See* Land, *supra* note 2, at 238.
[75] Prop. Treas. Reg. § 1.1275-1(b)(1), 51 Fed. Reg. 12,022, 12,084 (1986).
[76] *See* T.D. 7747, 1981-1. C.B. 141.
[77] T.D. 7920, 1983-2 C.B. 141.
[78] Gilbert v. Commissioner, 248 F.2d 399, 402 (2d Cir. 1957).

the less likely it will be treated as debt. Not all of the elements must be present, however, to characterize an instrument as indebtedness.[79]

The CVR bears little resemblance to a traditional debt instrument. The CVR payment is not a certain sum, nor does the CVR have a fixed interest rate. Furthermore, the issuer's obligation is qualified because the entire payment is contingent upon the strike price exceeding the share price at maturity. At best, a weak argument can be made that the CVR should be viewed as debt because it has a fixed maturity date and it is payable regardless of the debtor's income.

The recently proposed regulations on the bifurcation of contingent instruments[80] (the "Bifurcation Regulations"), however, further undercut the argument that the CVR is debt. Under the Bifurcation Regulations, contingent payments of a debt instrument are "treated in accordance with their economic substance as payments pursuant to one or more options or other property rights."[81] In other words, the contingent portion of a debt instrument is recharacterized as an option.

The Bifurcation Regulations currently do not reach the CVR because they apply only to instruments in which the "noncontingent payments [are] equal to or greater than the [instrument's] issue price."[82] However, there is conceptually no reason why a debt instrument with wholly contingent payments should be treated differently from the contingent portion of a bifurcated debt instrument.[83] Because they reinforce the government's position that contingent payment debt instruments are really options, the Bifurcation Regulations make it even more difficult to argue that the CVR should be treated as debt.

2. Tax Consequences from Treatment as Debt

a. *Distribution of the CVRs.* The tax treatment of a distribution of CVRs in an acquisition or as a takeover defense is relatively well established and is the same regardless of whether the CVR is characterized as debt or as an option. The amount

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[79] *Id.*

[80] Prop. Treas. Reg. § 1.1275-4(g), 51 Fed. Reg. 12,022, 12,094 (1986).

[81] *Id.* § 1.1275-4(g)(4)(i).

[82] *Id.* § 1.1275-4(g)(1), 51 Fed. Reg. at 12,095. Because the CVR has no fixed payments, its issue price will always exceed the noncontingent payments.

[83] *See* Frank V. Battle, Jr., *Bifurcation of Financial Instruments*, 69 TAXES 821, 829 (1991).

distributed to the shareholders is the fair market value of the CVR.[84] To the extent of the corporation's earnings and profits, the distribution is a dividend[85] and includable in the shareholder's ordinary income.[86] Any distribution in excess of earnings and profits is first a return of capital to the extent of the shareholder's basis in her stock,[87] and then capital gain once her basis is exhausted.[88] The holder's basis in the CVR is equal to the fair market value of the CVR.[89]

The only tax implication for the distributing corporation is a reduction in its earnings and profits account.[90]

b. *Sale or exchange of the CVR before maturity date.* Debt instruments are considered capital assets when held as investments.[91] Consequently, if the CVR is characterized as debt, the holder receives capital gains treatment on the sale or exchange of the CVR any time before the CVR matures.[92]

Treating gain or loss from the sale of the CVR as capital gain or loss seems strange because if the CVR is held to maturity, part of the CVR payment could be characterized as interest and included in the holder's ordinary income. In fact, CVR holders would be wise to take advantage of this difference in treatment; assuming that taxpayers can benefit from capital gains treatment, they should convert ordinary interest income into capital gains by selling the instrument on the market just before it matures.[93]

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[84] Determining the fair market value is often difficult. For a detailed explanation of the problem of valuing the CVR, see *infra* notes 256–268 and accompanying text. When the CVR is listed on a national securities exchange, the value of the CVR has been measured as of the first day that the CVR trades. *See* Lee A. Sheppard, *Dow's Explosive Mixture of Securities*, 46 TAX NOTES 9, 12 (1990).
[85] I.R.C. § 316(a)(1).
[86] *Id.* § 301(c)(1).
[87] *Id.* § 301(c)(2).
[88] *Id.* § 301(c)(3)(A).
[89] *Id.* § 301(d).
[90] *Id.* § 312(a).
[91] *Id.* § 1221.
[92] *Id.* § 1001(a).
[93] *See* Willens, *supra* note 70.

Capital gains treatment is different from ordinary income treatment in two important ways. First, long-term capital gain receives a slight tax preference. The maximum tax rate for long-term capital gain is 28%, I.R.C. §§ 1(h), 1222(11), even though the maximum ordinary income tax rate is 31%. *Id.* § 1(a)–(d). Second, an individual taxpayer can deduct capital losses only to the extent of capital gains recognized that year, plus $3,000 of ordinary income. *Id.* § 1211(b). Corporations can only deduct capital losses to the extent of capital gains. *Id.* § 1211(a).

c. *Payment on maturity of the CVR.* Characterized as a debt instrument, the CVR will be taxed in accordance with the contingent debt instrument rules under the OID provisions. Because the CVR has no fixed payments, its issue price will always exceed its noncontingent payments. When issued for cash or publicly traded property such as stock, the CVR is taxed in accordance with Proposed Treasury Regulation section 1.1275-4(f). Because the only payment on the CVR is made at maturity, the payment is considered first a return of principal, with any excess treated as interest.[94]

Issuers prefer to characterize the CVR as a debt instrument rather than as an option because if the CVR payment exceeds the principal, the issuer can deduct the excess of the CVR payment over the principal from its ordinary income as interest expense.[95] If the CVR payment is less than the principal, the excess of the principal over the amount paid is cancellation-of-indebtedness income to the issuer and includable in the issuer's ordinary income.[96]

The CVR holder is treated as having retired the CVR in exchange for the principal portion of the payment.[97] Amounts received on retirement of a debt instrument are treated as amounts received in exchange for the debt instrument.[98] Consequently, the holder has capital gain or loss on receipt of the principal, depending on his basis in the instrument.[99] However, any interest portion of the payment is ordinary income to the holder.[100] Thus, the CVR holder could unfortunately have both ordinary income from the maturity of the CVR and a potential capital loss on the underlying stock.[101] If the CVR is listed on a national security exchange, a taxpayer can avoid this situation by selling the CVR just before it matures.[102] Any gain realized

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[94] Prop. Treas. Reg. § 1.1275-4(f)(3), 51 Fed. Reg. 12,022, 12,093 (1986).

[95] *Id.* § 1.1275-4(f)(2)(i).

[96] I.R.C. § 61(a)(12). I.R.C. § 1032 does not extend nonrecognition treatment to debt instruments; hence, if the CVR is considered debt, the issuer recognizes gain or loss even if it issues rights contingent on its own stock. By contrast, the issuer does not recognize gain or loss if the CVR is characterized as an option and is contingent on the stock of the issuer. *See infra* notes 140–143, 147 and accompanying text.

[97] Prop. Treas. Reg. § 1.1275-4(f)(3), 51 Fed. Reg. 12,022, 12,092 (1986).

[98] I.R.C. § 1271(a)(1).

[99] *Id.* § 1222.

[100] Prop. Treas. Reg. § 1.1275-4(f)(2)(i), 51 Fed. Reg. 12,022, 12,092 (1986).

[101] This situation is created because of the inverse relationship between the value of the CVR and the value of a share of the underlying stock.

[102] *See* Willens, *supra* note 70.

on the sale of the CVR receives capital gains treatment,[103] and the gain could offset a capital loss on the underlying stock.

If the CVR is characterized as a debt instrument, the CVR and the share of stock do not form a straddle under I.R.C. § 1092[104] even though the value of the CVR varies inversely with the value of the stock; consequently, the CVR significantly reduces the risk associated with holding the share of stock. Stock is only part of a straddle when the offsetting position is an option with respect to the stock[105] or substantially similar property specified by regulation.[106] To date, no regulation has been promulgated that would extend the definition of "substantially similar property" to cover debt instruments like the CVR, even though it seems the straddle rules were intended to apply to just such a case. Although the Treasury could extend the straddle rules to debt instruments that substantially diminish the risk associated with holding stock, such regulations would apply only on a prospective basis.[107]

B. *Treatment of the CVR as a Cash Settlement Put Option*

1. Characterizing the CVR as a Cash Settlement Put Option

Since 1988, the government has increasingly characterized contingent payment obligations as put options.[108] The first step in redefining the tax treatment for contingent obligations came in Revenue Ruling 88-31,[109] in which the Internal Revenue Service (the "Service") held that a contingent payment right, much like the CVR, would be taxed in accordance with its substance as a cash settlement put option.[110] Most recently, the Treasury's

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[103] *See supra* note 92 and accompanying text.

[104] For a discussion of the tax implications of forming a straddle, see *infra* notes 130–139 and accompanying text.

[105] I.R.C. § 1092(d)(3)(B)(i)(I).

[106] *Id.* § 1092(d)(3)(B)(i)(II).

[107] *See* H.R. REP. No. 861, 98th Cong., 2d Sess. 907–08 (1984).

[108] A put is the right to sell a share of stock at a particular price. *See* Alan Feld, *When Fungible Portfolio Assets Meet: A Problem of Tax Recognition*, 44 TAX LAW. 409, 427 (1991).

[109] Rev. Rul. 88-31, 1988-1 C.B. 302.

[110] A cash settlement option is an option that does not actually require the holder to sell a share of stock; the option writer just pays the option holder the excess of the strike price over the share price in cash.

Bifurcation Regulations treat the contingent portion of a debt instrument as its option equivalent.[111]

The Service will almost certainly argue that under Revenue Ruling 88-31, the CVR should be taxed as a cash settlement put option.[112] The contingent payment right in Revenue Ruling 88-31 (the "Right") was issued in a recapitalization as part of an investment unit that also included a share of stock.[113] The Right entitled the holder to receive "an amount . . . equal to $11 minus the then market price of a share of . . . common stock."[114] With a floor price[115] of $3.67, the issuer limited its maximum payment on the Right to $7.33.[116]

The Service characterized the Right as a cash settlement put option for two reasons. First, the Right is like a put option because both the put and the Right place the holder in the same economic position with respect to the underlying stock, at least over a range of values.[117] Both instruments entitle the holder to receive a future payment based on the share price of the stock, and the value of both instruments varies inversely with the value of the stock.[118]

Second, the Right is similar to the cash settlement put option in particular because it can be settled in cash or property other than the common stock of the corporation.[119] Furthermore, the cash settlement put option, like the Right, does not actually require the holder to sell the underlying stock in exchange for the payment,[120] whereas the holder of a cash settlement put option receives the profit he would have made if he had bought and sold a share of the stock, without actually having to do so.

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[111] Prop. Treas. Reg. § 1.1275-4(g)(4), 51 Fed. Reg. 12,022, 12,094 (1986). For a discussion of the Bifurcation Regulations, see *supra* notes 80–83 and accompanying text.

[112] The CVR is similar to a European-style cash settlement put option in particular. European-style options are exercisable only on their maturity dates. *See* David P. Hariton, *The Taxation of Complex Financial Instruments*, 43 TAX. L. REV. 731, 738 n.26 (1988). In contrast, an American-style option is exercisable any time up to and including its maturity date.

[113] Rev. Rul. 88-31, 1988-1 C.B. 302.

[114] *Id.*

[115] For an explanation of floor prices, see *supra* note 7 and accompanying text.

[116] Rev. Rul. 88-31, 1988-1 C.B. 302.

[117] *Id.* at 303.

[118] *Id.*

[119] I.R.C. § 1234(c)(2)(B) (defining cash settlement option as "any option which on exercise settles in (or could be settled in) cash or property other than the underlying property").

[120] Rev. Rul. 88-31, 1988-1 C.B. 303.

The CVR is essentially equivalent to the Right in Revenue Ruling 88-31 with two minor differences. First, the Right guaranteed the holder a minimum payment of $.10 regardless of how well the stock performed;[121] the CVR generally does not have a minimum payment. Second, the Right was inseparable from the underlying stock for three months; thereafter, it traded independently from the stock.[122] The CVR, however, frequently trades separately from the stock from the moment it is issued. Both of these distinctions, however, are only additional reasons to treat the CVR as a cash settlement put option.

Arguably the CVR should not be characterized as a put because the contingent payment often has a maximum limit beyond which a shareholder is at risk for any further decline in share price.[123] A put is generally not limited in that it gives the holder the right to sell a share of stock at the strike price, regardless of how low the share price actually falls. Furthermore, the CVR can sometimes be paid off in the underlying stock; by definition, the cash settlement put option must be settled in property other than the underlying stock.[124] However, in Revenue Ruling 88-31, the Service found these distinctions to be insignificant reasons to alter its characterization of such rights as cash settlement put options.[125]

2. Tax Consequences from Treatment as a Cash Settlement Put Option

a. *Distribution of the CVR.* The tax consequences of distributing a CVR in an acquisition or as a takeover defense are the same regardless of whether the CVR is treated as a cash settlement put option or as a debt instrument. These consequences are discussed above in Part III.A.2.a, regarding the tax consequences from treatment of the CVR as debt.

b. *Sale or exchange of the CVR before maturity date.* When the CVR is characterized as a cash settlement put option, gain or loss from a sale or an exchange of the CVR before it matures receives capital gains treatment. In general, gain or loss from

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[121] *Id.* at 302.
[122] *Id.*
[123] *See supra* note 7 and accompanying text.
[124] I.R.C. § 1234(c)(2)(B).
[125] Rev. Rul. 88-31, 1988-1 C.B. 303.

sale of an option is considered capital gain or loss when the option is based on a capital asset.[126] Because the CVR is contingent on the value of stock, which is a capital asset,[127] the sale or exchange of the CVR receives capital gains treatment.

Characterizing the CVR as a cash settlement put option rather than as a debt instrument means that the holder of the CVR will be subject to the straddle rules of I.R.C. § 1092 if she also holds a share of stock.[128] The CVR and the stock are offsetting positions creating a straddle because the CVR substantially reduces the risk of loss associated with holding the stock.[129]

The straddle rules implicate both the timing and character of tax treatment on a sale or exchange of a CVR. First, the straddle rules limit the recognition of losses. Should the holder sell either position of the straddle at a loss and continue to hold the other position with unrealized appreciation, the loss can only be deducted to the extent it exceeds the unrealized appreciation on the offsetting position.[130] Any loss that cannot be deducted is carried into the succeeding tax year.[131]

Second, the straddle rules change the long-term/short-term capital gains rules.[132] In general, someone holding a CVR or stock for one year or less has short-term capital gain or loss,[133] while someone holding a CVR or stock for more than one year has long-term capital gain or loss.[134] Once a straddle is created, the holding period for capital gains treatment on both the CVR and the stock stops running. If neither position in the straddle was held for more than one year before the straddle was formed, the holder will have short-term capital gain or loss on the disposition of either position, regardless of how long she held the instrument in the straddle.[135] The holding period for the position she continues to own begins to run once the straddle is broken.[136]

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[126] I.R.C. § 1234(a).

[127] *Id.* § 1221.

[128] Rev. Rul. 88-31, 1988-1 C.B. 304. Debt instruments and stock do not form straddles under current law. *See supra* notes 104–107 and accompanying text.

[129] I.R.C. § 1092(c)(2)(A); Rev. Rul. 88-31, 1988-1 C.B. 304.

[130] I.R.C. § 1092(a)(1)(A).

[131] *Id.* § 1092(a)(1)(B).

[132] Only long-term capital gains are subject to preferential tax treatment. *Id.* §§ 1(h), 1222(11).

[133] *Id.* § 1222(1)–(2).

[134] *Id.* § 1222(3)–(4).

[135] Temp. Treas. Reg. § 1.1092(b)-2T(a)(1), (b)(1) (as amended in 1986).

[136] *Id.* § 1.1092(b)-2T(a)(1).

If one position in the straddle was held for more than one year before the straddle was formed, gain or loss on the sale of that position is still long-term capital gain or loss.[137] In addition, loss from the sale of the other position is also long-term capital loss, even though the position was not held for more than one year before forming the straddle;[138] gain on the sale of this position would still be short-term.[139]

c. *Payment on maturity of the CVR.* If the share price of the stock exceeds the strike price of the CVR, no payment will be required, and the CVR will lapse worthless. If one corporation issued CVRs contingent on the value of a second corporation's stock, as in the Dow Chemical/Marion transaction,[140] the issuing corporation must recognize short-term capital gain equal to the CVR's issue price on the lapse of the CVR.[141] However, if a corporation issued rights contingent on the value of its own stock, it does not have to recognize the gain.[142] I.R.C. § 1032 provides nonrecognition treatment for corporations dealing in their own stock or in options related to that stock.[143]

If the CVR's strike price exceeds the share price on the maturity date, the CVR will require a payment. In general, the settlement of a cash settlement option in cash is "treated as a sale or exchange of the option."[144] Consequently, the issuer is treated as having acquired the CVR when it makes the CVR payments.[145] If a corporation issued rights contingent on the value of another corporation's stock, it must recognize gain or loss on the maturity of the CVRs.[146] However, if the corporation issued rights contingent on the value of its own stock, I.R.C. § 1032 provides nonrecognition treatment so that the issuer does not have to recognize any gain or loss from making the payment.[147]

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[137] *Id.* § 1.1092(b)-2T(a)(2).
[138] *Id.* § 1.1092(b)-2T(b)(1).
[139] *Id.* § 1.1092(b)-2T(a)(1).
[140] *See supra* notes 34–44 and accompanying text.
[141] I.R.C. § 1234A.
[142] *Id.* § 1032; Rev. Rul. 88-31, 1988-1 C.B. 305.
[143] I.R.C. § 1032(a).
[144] Rev. Rul. 88-31, 1988-1 C.B. 303.
[145] *Id.* at 305.
[146] I.R.C. § 1001.
[147] Rev. Rul. 88-31, 1988-1 C.B. 305.

The issuer receives capital gains treatment when it makes a payment on the maturity of the CVR.[148] If the payment is less than the issue price, then the issuer has short-term capital gain equal to the excess of the issue price over the CVR payment.[149] If the payment exceeds the issue price, then the issuer has short-term capital loss equal to the excess of the CVR payment over the issue price.[150]

The holder also receives capital gains treatment on receipt of the CVR payment.[151] If the CVR lapses worthless, the holder has a capital loss.[152] If a payment is made when the CVR matures, the holder has either capital gain or loss depending on his basis in the CVR.[153] The section 1092 straddle rules also apply when the CVR matures. If the holder has a capital loss on the CVR, he cannot deduct the loss except that portion, if any, which exceeds any unrealized appreciation on a share of stock he continues to hold.[154] The characterization of the capital gain or loss as long-term or short-term is also affected by the straddle rules.[155]

3. Comparison of the Tax Treatment of the CVR as Debt and as an Option

The tax treatments for options and contingent debt obligations are similar in that recognition of income or loss is delayed until the contingency is resolved. For example, whether characterized as debt or as an option, the holder does not recognize any income until the CVR matures or is sold.

Options and contingent debt instruments, however, are taxed differently in two important ways. The first difference is that the entire CVR payment will receive capital gains treatment if the CVR is characterized as an option.[156] By contrast, part of that payment may be ordinary interest income to the CVR holder and ordinary interest deduction to the CVR issuer if the CVR is characterized as a debt instrument.[157]

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[148] I.R.C. § 1234A.
[149] *Id.*
[150] *Id.*
[151] *Id.* § 1234(a)(1); Rev. Rul. 88-31, 1988-1 C.B. 304–05.
[152] I.R.C. § 1234(a)(2); Rev. Rul. 88-31, 1988-1 C.B. 304.
[153] I.R.C. § 1234(a)(1); Rev. Rul. 88-31, 1988-1 C.B. 304–05.
[154] *See supra* note 130 and accompanying text.
[155] *See supra* notes 132–139 and accompanying text.
[156] *See supra* notes 148–153 and accompanying text.
[157] *See supra* note 94 and accompanying text.

The problem created by treating the CVR as debt is that the CVR holder may have ordinary income from the CVR as well as a corresponding capital loss on the share of stock.[158] An individual taxpayer may not be able to offset the gain on the CVR with the loss on the stock if her capital losses already exceed her capital gains by $3,000.[159] Of course, the holder can avoid this dilemma by selling the CVR on the market before it matures to convert the ordinary interest income into capital gains. However, if part of the CVR payment is properly treated as ordinary interest income to the holder, the taxpayer should not be able to elect out of the ordinary income treatment.

The second difference between debt and option treatment for the CVR is that the section 1092 straddle rules apply to cash settlement put options, but they do not apply to debt instruments. This difference in treatment seems unjustifiable because contingent debt instruments, like options, can offset the risk of holding a share of stock and therefore function as a straddle.

This difference in treatment under the section 1092 straddle rules also creates an opportunity for tax arbitrage. If the CVR is characterized as debt, the following arbitrage is possible. *Step 1*: On Jan. 1, 1992, Taxpayer issues a bond for $100, promising to pay $121 in two years. He gets OID interest deductions of $10 in 1992 and $11 in 1993. *Step 2*: Taxpayer uses the $100 to buy a share of stock and a CVR that guarantees the stock will trade at $121 on Jan. 1, 1994. He sells the stock on Jan. 1, 1994 for $120 and receives $1 from the CVR payment. He includes $21 in income in 1994.

Assuming that Taxpayer has other income to offset the interest deductions in 1992 and 1993 and assuming such income falls into the 31% tax bracket,[160] he reduces his tax liability by $3.10 in 1992 and by $3.41 in 1993. Although he must include $21 of income in 1994, Taxpayer benefits by having deferred taxes for two years. In effect, the government has made an interest-free loan to Taxpayer over the two-year period. Taxpayer could perpetuate the tax deferral by entering into another transaction that would produce $21 of interest deduction in 1994. The tax

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[158] Because the value of the CVR varies inversely with the value of stock, a gain on the CVR is often offset by a loss on the stock.

[159] I.R.C. § 1211(b).

[160] A corporate taxpayer can use the interest deduction to offset all other income. Individual taxpayers can deduct interest only to the extent of investment income. *Id.* § 163(d).

savings turns this otherwise unprofitable transaction into a profitable one.

If the CVR is characterized as a cash settlement put option, I.R.C. § 263(g) eliminates this arbitrage because it requires interest incurred to purchase a position in a straddle to be capitalized rather than currently deducted. However, if the CVR is characterized as a debt instrument, the owner of a share of stock and a CVR will not have created a straddle.[161] Consequently, section 263(g) does not apply to any interest incurred to purchase these instruments, and Taxpayer could successfully engage in this arbitrage.

The easiest way to eliminate this arbitrage is to treat the CVR as a cash settlement put option. Alternatively, the definition of a straddle could be expanded to include holding both a share of stock and a debt instrument whose value varies inversely with the stock. Section 263(g) would then require capitalizing any interest expense incurred to purchase the CVR.

IV. Inconsistent Tax Treatment Under the Current System

The differences in the tax treatment of the CVR depending on whether it is characterized as debt or as a cash settlement put option illustrate the inconsistencies in the tax system's approach to contingent payment obligations. The inconsistencies in the system, however, go beyond the variations in the possible tax treatments for the CVR. In Part IV.A, I explore other tax approaches to contingent payment obligations in the current system in an effort to show both how extensive the inconsistencies are and how taxpayers can dramatically change their tax consequences by investing in slightly different instruments. In Part IV.B, I outline some of the problems that the inconsistencies create for the tax system.

A. *Inconsistent Treatment of Five Contingent Payment Obligations Similar to the CVR*

1. Convertible Note

The tax system's approach to contingent debt instruments alone is remarkably inconsistent. The OID provisions provide

[161] *See supra* notes 105–107 and accompanying text.

three basic schemes for taxing contingent debt obligations issued for cash or publicly traded property, such as stock.[162] In all three schemes, recognition of income is delayed until the contingency is resolved. However, the characterization of income as ordinary or capital is different under each scheme.

When the noncontingent payments exceed the issue price of the contingent debt instrument, the instrument is divided into its contingent and noncontingent portions, and each portion is taxed separately.[163] The noncontingent portion is taxed as a separate debt instrument.[164] When the contingent portion is resolved by reference to publicly traded property, such as stock, it is recharacterized as "one or more options or other property rights."[165] Consequently, all gain or loss on the contingent payment is capital in nature, with no interest income recognized at all.[166] When the contingent portion is not resolved by reference to publicly traded property, however, the contingent payment is treated entirely as interest, which is ordinary income to the recipient and an ordinary deduction to the payor.[167]

When the noncontingent payments are less than the issue price of the contingent debt obligations, all fixed payments are treated as a return of principal; no part of the payment is interest.[168] The characterization of the contingent payment depends on whether the payment is made before or at maturity of the contingent debt obligation. Payments made before maturity are treated as interest to the extent interest has accrued at the applicable Federal rate; any excess is treated as a return of principal.[169] The treatment of the contingent payment is reversed when the payment is made at maturity. The payment is first a

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[162] Prop. Treas. Reg. § 1.1275-4(e)-(g), 51 Fed. Reg. 12,022, 12,090-96 (1986), *amended by* 56 Fed. Reg. 8308 (1991); 56 Fed. Reg. 12,423 (1991); 56 Fed. Reg. 31,350 (1991).

[163] Prop. Treas. Reg. § 1.1275-4(e)(1), (g)(2), 51 Fed. Reg. 12,022, 12,090-96 (1986).

[164] *Id.* § 1.1275-4(e)(2), (g)(3). The noncontingent debt instrument will have different amounts of OID depending on whether it is taxed under Prop. Treas. Reg. § 1.1275-4(e) or under Prop. Treas. Reg. § 1.1275-4(g). Prop. Treas. Reg. § 1.1275-4(e) allocates all of the instrument's issue price to the noncontingent portion. Prop. Treas. Reg. § 1.1275-4(g) allocates only part of the issue price to the noncontingent portion, with the remainder of the issue price allocated to the contingent portion. Consequently, the OID on the 4(g) noncontingent portion will be larger than the original issue discount on the 4(e) noncontingent portion.

[165] *Id.* § 1.1275-4(g)(4), 51 Fed. Reg. at 12,090.

[166] For an explanation of the tax treatment of options, see *supra* notes 141-155 and accompanying text.

[167] Prop. Treas. Reg. § 1.1275-4(e)(3)(i), 51 Fed. Reg. 12,022, 12,090 (1986).

[168] *Id.* § 1.1275-4(f)(1), 51 Fed. Reg. at 12,092.

[169] *Id.* § 1.1275-4(f)(2)(ii).

return of principal, with any excess treated as interest. Accrued interest is ignored.[170]

The importance of these differences can be illustrated by comparing the tax treatments of an investment in a CVR and a share of stock with an investment in a convertible note. A convertible note is essentially a zero-coupon bond with a right to convert the bond into stock.[171] For example, a taxpayer could purchase a convertible note for $100 on Jan. 1, 1992, that pays $121 on Jan. 1, 1994, and gives her the right to convert the bond into a share of stock on Jan. 1, 1994. This convertible note is similar to buying a share of stock on Jan. 1, 1992, and a CVR with a strike price of $121 and a maturity date of Jan. 1, 1994.[172]

These two investments are practically economic equivalents as of the maturity date of the CVR and the convertible note.[173] If the share price is $130, the convertible note holder will elect to receive stock instead of a cash payment; the CVR will lapse worthless, leaving the holder with a share of stock. If the share price is $110, the convertible note holder will opt to receive the $121 cash payment; the CVR/stock investor will own a share of stock worth $110 and will receive an $11 CVR payment for a total value of $121.

Because the issue price of the convertible note is $100 and the total noncontingent payments are $121, the note will be separated into its contingent and noncontingent portions; each portion will be taxed separately.[174] The noncontingent portion will accrue OID over the two-year life of the note at the instrument's yield to maturity.[175]

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[170] *Id.* § 1.1275-4(f)(3).

[171] *See* Ben Straughan, Note, *The Impact of Revenue Ruling 88-31 on the Tax Treatment of Contingent Debt Obligations that Are Based on Stock Price*, 43 TAX LAW. 807, 816–17 (1990).

[172] This example is based roughly on an example from Straughan. *Id.* Although I borrow his example, I disagree with Straughan's conclusion that the two investments are exactly equivalent at maturity. *See infra* note 173.

[173] The two investments are not exactly the same on maturity if the CVR has a floor price that limits the CVR payment; in that case, the CVR/stock investor may receive less than the convertible note holder. Corporate law differences also distinguish the two investments prior to maturity. The CVR/stock holder is an equity holder with the right to vote and the right to share in profits. The contingent note holder is a bondholder, thus enjoying preference in bankruptcy but no equity rights.

Otherwise, the investments are economically equivalent. An issuer would probably select between the two based upon which investment would receive more favorable tax treatment.

[174] *See supra* note 163 and accompanying text.

[175] I.R.C. § 1272(a).

The tax consequences of the contingent portion, however, depend on whether the holder can convert the bond into the issuer's stock or into the stock of a different corporation. If the conversion right gives the convertible note holder a right to receive stock of the note issuer, all contingent payments are treated as ordinary interest income.[176] However, if the holder can convert the note into stock of another corporation, the contingent portion is treated as a call option with a strike price of $121,[177] and any gain or loss will be characterized as capital.[178]

In contrast, no interest is imputed to the CVR/stock unit over the life of the investment regardless of whether the CVR is treated as debt or as an option. If the CVR is treated as an option, any gain or loss is capital[179] just as gain or loss is capital on the contingent portion of an instrument bifurcated under Proposed Treasury Regulation section 1.1275-4(g). If the CVR is treated as debt, the CVR payment will first be a return of principal with any excess treated as interest.[180] The payment is not treated entirely as ordinary interest income, unlike the treatment of contingent payments from an instrument bifurcated under Proposed Treasury Regulation section 1.1275-4(e).

2. Contingent Stock Right

The tax treatment of contingent stock rights received in a tax-free reorganization illustrates a second approach to the taxation of contingent payment obligations. The contingent stock right gives the holder the right to receive additional shares of stock at a future point in time based on share price at that time or on the net profits of the corporation.[181] In fact, the contingent stock right is just another way to describe a CVR that settles in its underlying stock. Furthermore, even a CVR that does not settle in the underlying stock is economically equivalent to the contingent stock right if transaction costs are ignored; once the instruments mature, the CVR holder can purchase stock with the CVR payment to be in the same economic position as the contingent stock right holder.

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[176] Prop. Treas. Reg. § 1.1275-4(e), 51 Fed. Reg. 12,022, 12,090 (1986).

[177] *Id.* § 1.1275-4(g).

[178] For a discussion of the capital gains treatment afforded options, see *supra* notes 146–151 and accompanying text.

[179] *See supra* notes 148–153 and accompanying text.

[180] *See supra* note 94 and accompanying text.

[181] Straughan, *supra* note 171, at 817.

When contingent stock rights are issued in a tax-free reorganization and are not separately transferable from the stock, they fall within the deferred payment rules of I.R.C. § 483. Under section 483,[182] income and loss on the contingent stock right are not recognized until an actual distribution is made or the contingent stock right lapses. In this respect, the contingent stock right is similar to options and contingent debt instruments: income from both options and contingent debt instruments is taxed when the contingency is resolved.

If a distribution of stock is ultimately made, section 483 requires that the fair market value of the stock distributed be discounted back to its present value in the year in which the contingent stock right was issued.[183] The applicable Federal rate is used as the discount factor.[184] The difference between the present value in the year in which the contingent stock right was issued and the fair market value of the shares distributed is treated as interest.[185] Thus, although income recognition is delayed until a distribution occurs, the tax system does account for the interest element of contingent stock rights, in contrast to its treatment of options and contingent debt instruments.

3. Bet

The tax system's approach to gambling is yet another way to treat contingent payment obligations. The CVR can be thought of as a bet on how well the holder thinks the underlying stock will perform.[186] Imagine that instead of buying a CVR on the American Stock Exchange, the taxpayer places a bet in a Las Vegas casino that the share price of a particular stock will be below a certain strike price, but above a certain floor price, two years from today.

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[182] *See* Treas. Reg. § 1.483-1(e)(3) Ex. 8; Rev. Rul. 70-300, 1970-1 C.B. 125. Some commentators have questioned whether I.R.C. § 483 continues to apply to contingent stock rights; they suggest that the proposed OID regulations on contingent debt instruments may apply instead. *See* David C. Garlock, Federal Income Taxation of Debt Instruments 198 (1991); New York State Bar Association Tax Section, *Report of Ad Hoc Committee on Proposed Original Issue Discount Regulations*, 34 Tax Notes 363, 400–01 (1987). However, it seems just as unlikely that contingent stock rights qualify as indebtedness as it does that CVRs will qualify as debt.

[183] *See* I.R.C. § 483(b).

[184] *Id.*

[185] *See id.* § 483(a), (b).

[186] *See* Battle, *supra* note 83, at 830 (comparing options to wagers).

The tax treatment of bets is quite different from the treatment of contingent debt instruments or options. Gambling winnings are treated as ordinary income and the deduction of gambling losses is limited to the extent of the taxpayer's gambling winnings for the year.[187] The only difference between the CVR and most bets is that most bets settle shortly after they are placed.[188] For example, NCAA college basketball pools are settled once the championship game is played, usually three to four weeks after the bets are placed. However, there is no reason that bets could not be placed more than one year out; under the current system, all winnings from such a bet would be treated as entirely ordinary income with no element of capital gain.

4. Section 1256 Contract

The most dramatic example of the tax system not following its traditional wait-and-see approach to contingent payment obligations is the treatment of options and contracts falling within the scope of I.R.C. § 1256. Section 1256 contracts include all regulated futures contracts,[189] foreign currency exchange contracts,[190] nonequity options,[191] and dealer equity options[192] that are listed on an exchange[193] or are traded on a market.[194] Section 1256 contracts do not include equity options,[195] which are options "to buy or sell stock"[196] or options whose value "is determined . . . by reference to any stock or stock index."[197] For example, characterized as a cash settlement put option, the CVR would be considered an equity option because its value is contingent on the value of stock. Consequently, unless owned by a dealer,[198] the CVR would not be considered a section 1256 contract.

Suppose, however, that the CVR's value depended on the performance of many stocks, rather than on just one particular

[187] I.R.C. § 165(d).
[188] *See* Battle, *supra* note 83, at 830.
[189] I.R.C. § 1256(b)(1).
[190] *Id.* § 1256(b)(2).
[191] *Id.* § 1256(b)(3).
[192] *Id.* § 1256(b)(4).
[193] *See id.* § 1256(g)(1), (3), (4)(C).
[194] *Id.* § 1256(g)(2)(A)(ii).
[195] *See id.* § 1256(b).
[196] *Id.* § 1256(g)(6)(A)(i).
[197] *Id.* § 1256(g)(6)(A)(ii).
[198] *Id.* § 1256(g)(4).

stock. Inversely tied to the value of Standard and Poor's 500 index, the CVR would no longer be an equity option.[199] Assuming that the CVR is listed on a national exchange, it would be considered a nonequity option, thus qualifying as a section 1256 contract.[200]

All section 1256 contracts are subject to a mark-to-market rule, which means that the holder of the option or contract must recognize gain or loss from an increase or decrease in the value of his option or contract on an annual basis.[201] The gain or loss is based on changes in the market value of the instrument from the last day of the previous year to the last day of the current year.[202] If the CVR were treated as a section 1256 contract, the holder would have to recognize gain or loss on the instrument every year. In contrast, if the CVR were treated as an equity option or a contingent debt instrument, the holder could defer recognition of gain into future years.

The gain or loss recognized when the instrument is marked to market value each year receives capital gains treatment; 40% of the gain or loss is considered short-term capital gain or loss, and 60% of the gain or loss is considered long-term capital gain or loss.[203] By contrast, gain or loss on equity options is either entirely long-term or entirely short-term capital gain or loss, depending on whether the option is held for more than one year[204] and whether it is held as part of a straddle.[205]

5. Insurance

A final approach to taxing contingent payment obligations is to treat them as insurance policies. To the extent that CVRs are issued or held to decrease the risk associated with the underlying stock, they can be characterized as a form of insurance. The CVR insures against the risk that the share price will decline below a particular level; if the share price does decline below that level, the insurance compensates the shareholder for his loss.

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[199] House Committee Report on P.L. 98-369, 1984 Tax Reform Act, July 18, 1984; *see also* Battle, *supra* note 83, at 827.

[200] House Committee Report on P.L. 98-369, 1984 Tax Reform Act, July 18, 1984.

[201] *See* I.R.C. § 1256(a).

[202] *See id.*

[203] *Id.* § 1256(a)(3).

[204] *See id.* §§ 1222(1)–(4), 1234(a)(1).

[205] *See supra* notes 132–139 and accompanying text.

The tax treatment for insurance policies is particularly complex and varies depending on the type of insurance. The CVR can be compared to a casualty insurance policy held by a corporation. A corporation that takes out a fire insurance policy on its building is able to deduct the premiums it pays as ordinary and necessary business expenses.[206] In contrast, amounts paid for the CVR must be capitalized.[207] The insurance company issuing the policy must include the premium in income upon receipt.[208] On the other hand, CVR issuers do not include the premium until the closing transaction.[209] To the extent casualty insurance proceeds are includible in income, they are treated entirely as capital gain;[210] proceeds from casualty insurance are generally offset by casualty loss, thus producing no net income.[211] Proceeds from the CVR could be ordinary or capital in nature, depending on how the instrument is characterized.[212]

The differences in tax treatment between insurance policies and the CVR, however, are more justifiable than the differences in treatment between the CVR and other contingent payment obligations discussed in this Part. First, a casualty insurance policy insures assets that are essential to the active business of the corporation. Consequently, insurance premiums should be deductible as ordinary and necessary business expenses.[213] CVRs, however, "insure" stock, which is a passive business investment. Hence the CVR premium should not be deductible as an ordinary and necessary business expense. Similarly, casualty insurance premiums are not deductible by individual homeowners because they do not qualify for the business expense deduction.

Second, although the treatment of insurance is an exception to the general rule that amounts received are not included in income when offset by a corresponding liability,[214] there are

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[206] *See* Treas. Reg. § 1.162-1(a) (1988).

[207] The cost of a put must be capitalized. Rev. Rul. 78-182, 1978-1 C.B. 265, 267. Similarly, no deduction is given for amounts invested in debt instruments.

[208] *See* I.R.C. § 832(b).

[209] Premiums received for writing a put are not included on receipt. Instead the put writer defers inclusion of the premium in income until the closing transaction. Rev. Rul. 78-182, 1978-1 C.B. 267–68. Similarly, the principal of a loan is not included in income because it is offset by a corresponding liability to repay the loan.

[210] I.R.C. § 165(h)(2)(B).

[211] *See id.* § 165(h).

[212] *See supra* notes 95–96, 99–100, 148–153 and accompanying text.

[213] I.R.C. § 162(a).

[214] For example, proceeds of a loan are not income to the recipient because they are offset by an obligation to repay the loan in the future. Similarly, an option writer does

special insurance tax rules that compensate in part for the immediate inclusion of insurance premiums in income. Specifically, there are special tax rules that sometimes allow an insurance company to deduct amounts added to reserve funds from the company's income.[215]

Third, CVRs are not a true insurance policy in the sense that they do not spread risk of loss over a group of taxpayers as insurance does. Insurance pools funds from a group of people that are all subject to the same risk of loss. The probability, however, is such that only a small percentage of the group will actually suffer the loss and then be compensated by the pool of funds. Unlike insurance holders, the holders of CVRs and other contingent payment instruments are all subject to the same outcome; if one loses, all lose. In light of these differences between insurance and contingent payment obligations like the CVR, the tax approach to insurance is not necessarily the approach that the tax system should apply to contingent payment obligations.

6. Summary

This Part illustrates that contingent payment obligations with relatively close economic equivalence to the CVR receive vastly different tax treatments. Both the character of income and the timing of income recognition vary over a range of possible treatments. Although the recognition of income on most contingent payment instruments is delayed until the contingency is resolved, section 1256 contracts demonstrate a marked departure from that approach by requiring the annual recognition of gain or loss. The character of income or loss from contingent payment obligations could be (1) entirely ordinary, (2) partially capital and partially ordinary, (3) all short-term capital, (4) partially short-term capital and partially long-term capital, or (5) all long-term capital. The problems created by these inconsistencies are discussed in the next Part.

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not have to include option premiums in income until the closing transaction. *See* Rev. Rul. 78-182, 1978-1 C.B. 267–68.

[215] Although no such provision seems to exist for casualty insurance companies, I.R.C. § 805(a)(2) allows net increase in life insurance reserves to be deducted from income, and I.R.C. § 832(e)(1) allows mortgage guarantee insurance losses to be deducted from income. *See* 12 JACOB MERTENS, JR., MERTENS LAW OF FEDERAL INCOME TAXATION §§ 44.15, 44A.01 (Martin M. Weinstein ed., 1992).

B. *Problems with Inconsistent Treatment*

Inconsistent treatment of contingent payment obligations creates a number of problems for the tax system. First, the system becomes susceptible to taxpayer manipulation. Taxpayers can pick and choose among a variety of instruments that have essentially similar characteristics yet different tax treatments.[216] Taking advantage of the inconsistencies, taxpayers will structure transactions to minimize taxes.[217] For example, instruments generating ordinary income and ordinary deductions will be issued by taxpayers with significant taxable income and purchased by tax-exempt taxpayers or corporations with large net operating loss carryforwards.

Second, and related to taxpayer manipulation, the inconsistencies leave open opportunities for tax arbitrage. For example, if the CVR is treated as debt, a taxpayer could borrow on an OID basis to invest in the CVR/stock unit. The taxpayer will receive interest deductions over the life of the investment, while deferring income into the future. Thus, an unprofitable transaction before taxes can quickly become a profitable one after taxes.

Third, opportunity for whipsawing the government increases.[218] CVR issuers will try to characterize the instrument as debt so that they can get interest deductions. CVR holders, however, will characterize CVRs as options so that they can offset the gain on the CVR with the capital loss from their stock. The government has to be more aggressive in making sure everyone treats the instrument the same way.

Fourth, determining how new financial instruments are to be taxed under the current system becomes much more difficult and more costly.[219] How the instrument is categorized is vitally important to the instrument's tax consequences, yet "the boundaries between categories are sometimes vague and poorly defined."[220] This tax uncertainty may hamper the development of new financial instruments that are economically desirable.

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[216] *See* Robert H. Scarborough, *Payments in Advance of Performance*, 69 TAXES 799, 814 (1991).

[217] *See* Land, *supra* note 2, at 284.

[218] Dow Chemical's corporate tax manager has suggested that the CVR issuer and the CVR holder "do not necessarily have to have parallel tax treatment." Sheppard, *supra* note 84, at 11.

[219] *See* Scarborough, *supra* note 216, at 814, 820.

[220] *Id.* at 814.

The current explosion of these new financial instruments into the market only magnifies the problems for the tax system.[221] Not only is the number of products available increasing,[222] but the constituency of taxpayers holding the instruments is changing. The instruments are now increasingly sold to the general public, which rarely purchased such instruments in the past.[223] It is quickly becoming apparent that we need a consistent approach to the taxation of all contingent payment obligations, an approach that depends not on how we characterize the instrument but on the economic substance of the product.

V. INCORRECT TAX TREATMENT UNDER THE CURRENT SYSTEM AND PROPOSALS FOR REFORM

In addition to creating its own problems for the tax system, the inconsistencies within the current system also raise the question of how contingent payment instruments like the CVR should be taxed, both in terms of the timing of income recognition and the character of the income when recognized. In Part V.A, I first argue that the current system's treatment of options and contingent debt obligations incorrectly times the recognition of income. I then propose three ways that the system could more accurately tax income from these instruments. In Part V.B, I examine whether the income or loss on contingent payment instruments should be capital or ordinary, and I propose that it should be a combination of the two.

A. *Timing of Income Recognition*

1. The Wait-and-See Approach of the Current System

The very nature of a contingent payment obligation is that the eventual return from the instrument cannot be determined until the contingency is resolved at some future point in time; the CVR holder could either make money or lose money. Because contingent payment obligations have no fixed return, it is difficult to measure the income accruing on the instrument until

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[221] *See id.* at 799.

[222] *See* Henry T.C. Hu, *New Financial Products, the Modern Process of Financial Innovation, and the Puzzle of Shareholder Welfare*, 69 TEX. L. REV. 1273, 1274 (1991).

[223] Hariton, *supra* note 112, at 732.

the outcome is certain.[224] Furthermore, it seems unfair to impute income on an investment that may never be realized.

With these considerations in mind, the taxing authority has been reluctant to require the recognition of income on contingent payment instruments until the contingency is resolved, an approach sometimes referred to as the "wait-and-see approach." For example, regardless of whether the CVR is characterized as a cash settlement put option or as debt, the holder does not have to recognize any income on the CVR until the instrument matures or is sold. Recognition of income on an equity option is delayed until the option lapses or is exercised, sold, or exchanged.[225] Similarly, the OID rules for contingent debt instruments delay recognition of income on the contingent portion of an instrument until a payment is actually made.[226]

2. A More Ideal Approach to Recognition of Income from Contingent Payment Obligations

In its haste to demand certain outcomes before taxation, the tax system has largely ignored changes in the value of contingent payment obligations over time.[227] Income under the Haig-Simons definition includes all changes in the taxpayer's net worth,[228] regardless of whether a realization event occurs. The correct measure of income from the contingent payment obligation, then, is the net change in the value of the instrument for the year. Ideally, the tax system should account for these changes in value by requiring taxpayers to recognize gain or loss from their contingent payment obligations on an annual basis.[229]

For purposes of determining the value of the contingent payment obligation, it is helpful to think of the obligation as a combination of two distinct components: a loan and a bet.[230]

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[224] Land, *supra* note 2, at 262; *see also* Walter & Strasen, *supra* note 22, at 494.

[225] *See supra* notes 141–155 and accompanying text.

[226] *See supra* notes 163–170 and accompanying text.

[227] Section 1256 contracts, which are marked to market value each year, are obviously an exception to the system's general approach. *See supra* notes 201–202 and accompanying text.

[228] Daniel I. Halperin, *Interest in Disguise: Taxing the "Time Value of Money"*, 95 YALE L.J. 506, 508–09 (1986).

[229] *Id.*; Scarborough, *supra* note 216, at 803.

[230] Scarborough, *supra* note 216, at 801 (arguing that a contract with an advance payment can be separated into a "loan and an agreement for the specified performance"); *see also* Battle, *supra* note 83, at 827; Hariton, *supra* note 112, at 737.

For example, a CVR that matures in three years can be thought of as a loan for three years and a bet that the share price will be between the CVR strike price and any CVR floor price when the instrument matures.

The expected value of the bet is based on the probabilities associated with potential share prices on the CVR maturity date. As the CVR matures, the expected value could increase or decrease as the probabilities change;[231] the increase or decrease is gain or loss to the CVR holder. There is, however, no way to predict whether the bet element will appreciate or depreciate in value.[232]

Although the value of the bet may increase or decrease over time, the value of the loan is certain to increase as interest accrues on the principal. The loan element of the CVR is the amount paid in year one for a bet that will not settle until year four. Over the three-year period between the issuance of the CVR and the maturity of the instrument, the bet writer has the use of the amount exchanged for the CVR, for which the bet writer should owe interest to the bet holder.[233] The loan is essentially a zero-coupon bond because interest is paid at maturity rather than in periodic intervals over the life of the instrument. At the end of three years, the redemption price of the bond is used to purchase the bet.[234]

The value of the contingent payment obligation should be equal to the value of the sum of its parts. Consequently, whether the tax system takes into account the changes in the value of the instrument as a whole or the changes in the value of the loan element and the bet element, the tax system would correctly tax the holder of a contingent payment obligation.

3. Implementing a More Ideal Income Recognition Approach to Contingent Payment Obligations

Implementing an ideal tax system that would account for all changes in net value of contingent payment obligations is difficult to do in practice. Three alternative approaches to the current system, however, would more appropriately and more con-

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[231] *See* Scarborough, *supra* note 216, at 804.
[232] *See id.*
[233] Interest is generally compensation for the use of money over time. *See* Hariton, *supra* note 112, at 734.
[234] Scarborough, *supra* note 216, at 801.

sistently tax contingent payment obligations. In this section, I explore a mark-to-market regime for all publicly traded options and debt instruments, an income imputation scheme for all options and debt instruments, and finally a limited income imputation scheme for investments held in straddles. Each solution is evaluated for its advantages and limitations.

a. *Mark-to-market approach.* A mark-to-market regime would implement the theoretically ideal approach to taxing contingent payment obligations by accounting for changes in the market value of the entire contingent payment obligation.[235] Recall that regulated futures contracts, foreign currency exchange contracts, nonequity options, and dealer equity options fall within section 1256's mark-to-market regime, which requires the holder of the option or contract to recognize the increase or decrease in the value of her instrument on an annual basis.[236] This regime could be extended to apply to non-dealer equity options, as well as debt instruments, that are listed on a national exchange or traded on a market. Gain or loss would have to be recognized each year on all publicly traded options and debt instruments regardless of whether the instrument lapses or is sold, exchanged, or exercised.

Although this scheme theoretically would tax contingent payment obligations correctly, it has its limitations. The first limitation is that the scheme requires that the options and debt be publicly traded so that a market value is readily available to measure gain and loss each year. Many options and debt instruments are not publicly traded, and these instruments would escape annual taxation. Investors would prefer to invest in privately traded instruments rather than publicly traded instruments with an otherwise equivalent return because income on the privately traded instruments would be deferred into future years. The fear of giving an advantage to privately traded property over publicly traded property may be the primary reason Congress has not extended the mark-to-market rules to equity options.[237]

The second limitation is that if we mark options and debt instruments to their market values on an annual basis, there is

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[235] *See id.* at 803.
[236] *See supra* notes 189–197, 201–202 and accompanying text.
[237] Land, *supra* note 2, at 279, 302.

no reason not to extend mark-to-market treatment to publicly traded stock as well.[238] In fact, if we do not mark stocks to market value each year, we have only shifted the inconsistency within the system, not removed it. The put/call theorem demonstrates that an investment in a share of stock A and a put on Stock A with a strike price of $k is economically equivalent to an investment in a call on Stock A with a strike price of $k[239] and a debt instrument with a maturity value of $k.[240] Under the current system, a taxpayer investing in a share of stock and a put can defer the recognition of gain until the put expires or the instruments are sold or exchanged. A taxpayer investing in the economically equivalent investment of a call and debt must accrue OID income on the debt instrument, thus recognizing income on an annual basis. This distinction is the key difference between the convertible note and the CVR/stock unit.[241]

By marking options and contingent debt instruments to market value, the line between inconsistent treatment has merely been shifted. If someone holding a call on Stock A with a strike price of $k and a debt instrument with a maturity value of $k writes a put on Stock A with a strike price of $k, she holds a position economically equivalent to holding a share of Stock A.[242] A taxpayer investing in a share of stock would still not have to recognize gain or loss until she chooses to do so. In fact, if the taxpayer dies, the deferral turns into complete exemption from taxation because basis is stepped up to fair market value.[243] By holding the economically equivalent investment in calls, puts, and debt, however, the taxpayer would be required to recognize gain or loss each year. Although marking options and contingent debt instruments to market value without extending the same treatment to stock only shifts the inconsistency in the system, at least more of the income from these instruments would be taxed correctly, even if it continues to be taxed inconsistently.

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[238] *See id.* at 279 ("[I]t is difficult to distinguish . . . listed options from other exchange-traded property such as common stocks.").

[239] A call with a strike price of $k gives the holder of the call the right to buy a share of stock for $k. *See* Feld, *supra* note 108, at 426.

[240] *See* BREALEY & MYERS, *supra* note 28, at 435.

[241] *See supra* notes 174–180 and accompanying text.

[242] This theorem follows from the put/call theorem discussed in the preceding paragraph. *See supra* notes 239–240 and accompanying text.

[243] I.R.C. § 1014(a)(1).

The third limitation is simply a political one. Implementing a mark-to-market regime is essentially a rejection of the income realization requirement, a step Congress is unlikely to take. In fact, it is questionable whether we could administer a tax system without a realization requirement. Thus, the mark-to-market regime remains a theoretically correct but impracticable approach to the taxation of all contingent payment obligations.

b. *Imputing income on the loan element.* Given the problems of marking contingent payment instruments to market value, it is not feasible to account for annual changes in the net worth of the bet element of a contingent payment obligation. At this point, the traditional wait-and-see tax approach seems appropriate because we cannot determine ex ante what the outcome of the bet will be.[244]

However, adopting a wait-and-see approach for the bet element is no reason to treat the loan element of the contingent payment obligation in the same way. Unlike the bet element, the value of which may increase or decrease,[245] the loan element always increases in value as the borrower compensates the lender with interest for the use of money over time. Regardless of whether the instrument is called an option or a contingent debt instrument, interest should be imputed on the value prepaid for the bet, even if the system cannot measure the changes in value of the bet.[246] The holder of a contingent payment obligation should include in income the interest accruing on the loan.[247] Correspondingly, the issuer of the contingent payment obligation should receive a deduction for the interest implicitly paid to the holder.[248]

For example, interest should be imputed on the amount invested in the CVR. If a CVR with a two-year maturity date is purchased for $10, the holder should have interest income equal to $1 in the first year and $1.10 in the second year, assuming that the appropriate interest rate is 10%. The issuer should correspondingly receive interest deductions of $1 in the first year and $1.10 in the second year.

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[244] Scarborough, *supra* note 216, at 803–04.
[245] *Id.* at 803.
[246] *Id.* at 801.
[247] *Id.*
[248] *Id.*

Three practical problems could hinder the implementation of this approach. The first problem is determining the appropriate interest rate to use to impute interest on the contingent payment obligation. Probably the best rate to use is the applicable Federal rate ("AFR"),[249] which generally represents a risk-free rate of return on investments.[250] Assuming that the investor wants to maximize his income, the holder of a contingent payment obligation maturing in a future year must believe that he will receive at least the risk-free rate of return. Otherwise, he would invest in Treasury bills[251] and purchase the contingent payment obligation just before it matures.

The AFR probably underestimates the true interest income generated by the instrument because it does not include a premium for the risk assumed by the lender that the borrower will default, a premium that the market would demand.[252] We could use the market interest rate for debt instruments of comparable risk and duration.[253] This solution, of course, does not solve the problem for privately traded debt instruments.[254] Furthermore, finding a comparable fixed-rate debt instrument will often be difficult[255] and will produce litigation between taxpayers and the Service over exactly which rates are comparable. The certainty offered by using the AFR is appealing because it offers an administrable way to make a first cut at measuring the interest accruing on the instrument.

The second problem is determining the principal of the loan so that interest can be computed by applying the AFR. The principal of the loan should be the value of the contingent payment obligation when it is issued. If we knew the expected value of the contingent payment obligation when it matures, we could determine its value when issued by discounting its expected value to present value; the AFR would be an easily determinable discount factor to use.[256] Evaluating the expected value of the contingent payment obligation, however, requires a determination of the probability of each potential share price of the stock

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[249] I.R.C. § 1274(d) controls how the AFR is set for the original issue discount regulations. The AFR is already used to impute interest on contingent debt obligations under Prop. Treas. Reg. § 1.1275-4(f)(2), 51 Fed. Reg. 12,022, 12,092 (1986).

[250] *See* Scarborough, *supra* note 216, at 801.

[251] *See id.* at 804.

[252] *See* Hariton, *supra* note 112, at 741.

[253] *Id.* at 742.

[254] *See* Land, *supra* note 2, at 299.

[255] Hariton, *supra* note 112, at 742; Land, *supra* note 2, at 299.

[256] *See* Scarborough, *supra* note 216, at 804 n.42.

when the instrument matures. Because these probabilities are difficult to measure with any certainty, this method of valuation is not an appealing approach for the tax system.[257]

When the contingent payment obligation is received in exchange for cash or publicly traded property, valuation of the obligation is simple; the market price will establish the initial principal of the loan.[258] Issued in a merger, however, the contingent payment obligation can be difficult to value. The CVR issued in Dow Chemical's acquisition of Marion illustrates this problem. Dow Chemical exchanged Merrell Dow shares and CVRs for Marion shares.[259] The value of the CVRs, therefore, should have been the value of the Marion shares less the value of the Merrell Dow shares.

The CVRs were difficult to value in part because Merrell Dow was a wholly owned subsidiary. Consequently, its shares were not publicly traded and had no easily ascertainable market price. But even the value of the Marion shares, which were publicly traded, would not have been easy to determine. Once a merger is announced, the share price jumps up in expectation of a tender offer that will pay a premium on the shares.[260] Whether we rely on the share price before or after the merger to value the Marion shares depends on how efficient we believe the capital markets are. If markets are inefficient, the Marion stock could have been undervalued before the tender offer;[261] thus, arguably we should rely on the market price after the merger was announced as the true value of the stock. If markets are efficient, however, the share price after the merger announcement is really an inflated value based on an expectation that someone will offer a premium to purchase a control block.[262] Thus, we should rely on the share price before the merger was announced to value the Marion shares.

One solution to the valuation problem of the contingent payment obligations issued in a merger has been to look at the

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[257] Land, *supra* note 2, at 283.

[258] If the CVR holder buys the CVR from the issuer or from a third party on the market, the value of the CVR is the price paid. When the CVR is issued in a recapitalization, as part of an investment unit also containing a share of publicly traded stock, the value of the CVR is the purchase price of the investment unit less the share price of the stock.

[259] *See supra* notes 32–35 and accompanying text.

[260] *See* BREALEY & MYERS, *supra* note 28, at 711.

[261] *See id.* at 712. Brealey and Myers do not believe that the evidence supports the market inefficiency theory.

[262] *See id.* at 711.

market value of the contingent payment obligation on its first day of trading on a national security exchange. For example, the when-issued value of Dow Chemical's CVR was measured as of the first day that the instrument traded on the American Stock Exchange.[263] However, the marketplace seems to lack adequate information about these instruments, which raises questions about how accurately the when-issued trading price reflects the true value of the instrument.[264] Theoretically, the market value of the CVR and the market price for the share should at least equal the present value of the CVR's strike price.[265] In practice, however, the combined market value of the CVR and a share of stock are frequently less than the present value of the strike price,[266] indicating that the market may not be correctly pricing the CVR.[267] Insignificant trading volume in an instrument on the first day the instrument is listed on an exchange also indicates lack of understanding about the instrument. On the first day that the Brooke Group CVR was listed on the New York Stock Exchange, only 10,000 CVRs were purchased, of which Shearson Lehman Brothers, Brooke Group's investment bankers, purchased 7100.[268]

Valuation problems become even more difficult when the contingent payment obligation is not issued in exchange for anything, as in a takeover defense. Similarly, contingent payment obligations issued in bankruptcy reorganization plans will also be very difficult to value because the value of the entire reorganized corporation is hotly contested.

The third problem with an imputation-of-interest approach is the inconsistent treatment afforded stocks on the one hand and debt, calls, and puts on the other hand. By imputing interest at the AFR to contingent payment obligations characterized as debt or options, the system would create the same bias dis-

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[263] *See* Sheppard, *supra* note 84, at 12.

[264] *See Brooke Group's CVRs Finally Begin Trading*, INVESTMENT DEALERS' DIG., Jan. 21, 1991, at 4.

[265] In fact, the market value of the CVR/stock unit should be slightly more than the present value of the strike price to account for the fact that the combined investment eliminates the downside risk associated with holding either position alone, yet the holder continues to enjoy the upside advantages of the stock. Thus, the holder should be willing to pay slightly more for the combined investment.

[266] *See Brooke Group's CVRs Finally Begin Trading*, *supra* note 264, at 4 (reporting that the Brooke Group CVR and share of stock were trading "well below the current target price of 12").

[267] *Id.* Another explanation may be that CVR holders are uncertain about the credit worthiness of the issuer. *Id.*

[268] *Id.*

cussed under the mark-to-market approach for investing in stock over an equivalent investment in debt and options.[269] Arguably the system should impute interest income to stocks as well, on the theory that the investor must believe she will receive a return at least equal to the AFR; otherwise, she would have invested in Treasury bills rather than stock.[270]

c. *Imputing income to investments in a straddle.* Even if we decide that we cannot impute interest income to contingent payment obligations or mark such instruments to market value each year, we can still improve the current system. It is the contingent nature of the contingent payment obligation that justifies the wait-and-see approach. Hence, when the income from a contingent payment obligation becomes fixed, there is no reason not to recognize the income as it accrues.[271]

For example, when someone holds both a CVR with an unlimited payment and a share of the stock upon whose value the CVR depends, the CVR holder is guaranteed to receive at least the CVR strike price when the CVR matures.[272] Under current law, we do not tax any appreciation on the stock or the CVR until the CVR matures or either instrument is sold. The taxpayer, therefore, can defer income until the CVR matures, and possibly longer if the share price exceeds the strike price at maturity.

The tax system should instead recognize that the combination of instruments has produced a fixed payment obligation.[273] We could recharacterize the stock/CVR investment as a call plus debt,[274] arguing that the economic substance of the investment should govern the tax consequences. We could then impute OID income on the debt portion of the investment, which is the increase in present value of the CVR's strike price over time. This approach would not require abandoning the realization principle for investments in stocks or options.

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[269] *See supra* notes 238–243 and accompanying text.

[270] *See* Scarborough, *supra* note 216, at 804.

[271] *See* Feld, *supra* note 108, at 429.

[272] The combined investment is actually worth more than the strike price of the CVR because the holder continues to enjoy the upside returns associated with the stock. *See supra* note 265.

[273] *See* Land, *supra* note 2, at 280.

[274] From the put/call theorem, we know that holding a share of stock and a put with a strike price of $k is economically equivalent to holding a call with a strike price of $k and the present value of $k. *See* BREALEY & MYERS, *supra* note 28, at 435.

Alternatively, we could adopt a rule imputing OID income to investments forming a straddle.[275] Because a straddle substantially reduces the risk associated with holding the individual investments, a minimum amount of income from the combined investment unit is locked-in;[276] the investor is relatively certain to receive a specific minimum return. The yield to maturity of the combined investment unit can easily be determined and OID income can be imputed to the investor. This rule would require relaxing the realization requirement, but only for investments creating a straddle.

To illustrate how OID income could be imputed on the stock/CVR investment, take the CVR example described above.[277] Assuming a 10% interest rate, the strike price of $121 has a present value on Jan. 1, 1992, equal to $100. The tax system should impute to the holder $10 of OID income in 1992 and $11 of OID income in 1993. Correspondingly, the CVR issuer would receive interest deductions equal to $10 in 1992 and $11 in 1993.

The system would have to resolve how the OID income should be allocated between the holder's bases in two investments. Basis becomes important when either investment is sold or matures. Basis should be allocated in relation to the actual increase in value of the instruments, which is easily determined when either instrument is publicly traded. In the stock/CVR example, OID income should first be allocated to the holder's basis in the stock to the extent that the share price rose; any excess would then be added to the holder's basis in the CVR. If the share price increases from $100 to $105 during 1992, then we would allocate $5 of the OID income to the shareholder's basis in the stock and $5 to her basis in the CVR.

When the CVR payment has a maximum limit, and therefore the CVR reduces only part of the risk associated with the stock, measuring the original issue discount of the combined investment becomes more complicated. In computing the yield to maturity of the stock/CVR unit, we have to account for the probability that the stock will fall below the CVR floor price, exposing the shareholder to risk of loss. This problem does not

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[275] *But see* Land, *supra* note 2, at 280 (arguing that before income is considered locked-in, the contingent payment instruments should "be offsetting in a strong sense, stronger than may be contemplated by the 'substantial reduction in risk of loss' standard of the straddle rules").

[276] *See id.* at 271 n.180, 280.

[277] *See supra* p. 6.

arise if the CVR payment is unlimited because the holder is guaranteed to receive the strike price. Once we start measuring the probabilities associated with the performance of stock for straddles, arguably we should also be imputing OID income on all options and stock as well.

As a compromise to avoid having to measure the probabilities associated with potential stock outcomes, we could adopt a rule that if the maximum CVR payment is at least 50% of the strike price, OID income is imputed to the stock/CVR investment as if the CVR payment were not limited. If the maximum CVR payment does not equal at least 50% of the strike price, no income would be imputed to the investment.

B. *Character of Income*

Whether the character of gain or loss from a contingent payment should be capital or ordinary is also an issue that the current system does not treat correctly for contingent payment obligations. In this section, I discuss the differences between capital and ordinary treatment as background for a decision about how income from contingent payment obligations should be characterized. I then propose that all imputed interest should be treated as ordinary income, and all other gain or loss should be treated as capital.

1. The Differences Between Capital and Ordinary Treatment

Capital gains treatment and ordinary income treatment differ in two ways. First, long-term capital gains receive preferential tax treatment. Under current law, the maximum tax rate for income characterized as long-term capital gains is 28%;[278] by contrast, the maximum rate for ordinary income is 31%.[279] In the past, capital gains preferences have been as large as 60%, leaving only 40% of the gain to be taxable income. Although the preference today is quite small, there is political pressure to increase the preference.

Second, corporate taxpayers can deduct capital losses only to the extent of their capital gains,[280] and individual taxpayers

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[278] I.R.C. §§ 1(h), 1222(11).
[279] *Id.* § 1(a)–(d).
[280] *Id.* § 1211(a).

can deduct capital losses only to the extent of capital gains plus $3,000.[281] Because our tax system is based on the income realization principle, taxpayers can control when they recognize both income and loss on their investments. The limitation on the deductibility of capital loss is designed to reduce the taxpayer's ability to minimize her taxes by recognizing losses in the current year and deferring gain until future years.[282]

2. Proposal for a More Correct Characterization of Income from Contingent Payment Obligations

Rather than treating all income derived from a contingent payment obligation as either capital or ordinary, the best approach is to recognize that the investment produces both types of income. Interest accruing on the loan element of the contingent payment obligation should be ordinary income.[283] It is money earned from the use of a capital asset, just like dividends from stock or interest from any other loan.

Gain or loss on the bet element, however, should be treated as capital. The interest on the loan element already compensates the instrument holder for the use of the money over time.[284] All other gain and loss is produced by the resolution of the contingency, which has nothing to do with the compensation received by the holder for the use of the money loaned to the issuer.

Furthermore, because the loan element is always increasing in value, we know that a decline in the value of the contingent payment obligation must be due to a decline in the value of the bet. The tax system should discourage taxpayers from selectively recognizing losses when the contingent payment obligations decline in value just as the system discourages taxpayers from selectively recognizing their losses on stock. At the same time, the contingent payment obligations are investments that taxpayers may hold for a significant period of time. To the extent that we want to encourage the purchase of such instruments, contingent payment obligations should receive any capital gains preference available to other capital assets.

Proposed Treasury Regulation section 1.1275-4(f) comes close to implementing this proposal. When noncontingent pay-

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[281] *Id.* § 1211(b).

[282] *See* Feld, *supra* note 108, at 412–13.

[283] *See* Scarborough, *supra* note 216, at 807.

[284] *See* Hariton, *supra* note 112, at 740–41.

ments are less than the issue price on a contingent debt obligation and the debt is issued for cash or publicly traded property, interest accrues at the AFR.[285] Any contingent payments made before maturity are considered interest to the extent interest has accrued and then a return of principal.[286] If the principal is not repaid by maturity, the holder recognizes a capital loss because debt is treated as a capital asset.[287] The proposed regulation does not fully implement the proposal, however, because the final payment at maturity of the contingent debt obligation is first considered a return of principal, and any excess is interest.[288] Thus, the tax treatment of the final payment ignores the accrued interest and minimizes the capital loss on the return of principal.

The characterization of income from the bet element as capital gain may be criticized on the grounds that gambling winnings are generally taxed as ordinary income.[289] Arguably the bet element of the contingent payment obligation should not be treated any differently from a regular bet. However, the argument may prove too much. We could also characterize investing in stock or in junk bonds as gambling because the investor is essentially making a bet that the stock price will rise or that the junk bonds will be paid off.[290] A decision to extend ordinary income treatment to all gain or loss from securities should be founded on a belief that the justifications for capital gains treatment are not legitimate concerns; the decision should not just be a blind extension of the treatment of gambling winnings and losses.

VI. Conclusion

The treatment of contingent payment obligations under the current tax system is inconsistent and frequently does not account for changes in the value of the instruments until the

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[285] I.R.C. § 1274(d) controls how the AFR is set for the OID rules.
[286] Prop. Treas. Reg. § 1.1275-4(f)(2), 51 Fed. Reg. 12,022, 12,092 (1986).
[287] *See supra* note 91 and accompanying text.
[288] Prop. Treas. Reg. § 1.1275-4(f)(3), 51 Fed. Reg. 12,022, 12,092–93 (1986). The regulation also fails to time income recognition correctly. Rather than recognizing interest as it accrues at the AFR, the holder defers the recognition of interest until a contingent payment is actually made. *See supra* notes 163–170 and accompanying text.
[289] *See supra* note 187 and accompanying text. *See generally* Hariton, *supra* note 112, at 740 n.36.
[290] *See generally id.*

contingencies are resolved. Faced with increasing numbers of new contingent payment obligations, such as the CVR, we must find a better way to tax these instruments lest the tax base be eroded by taxpayers structuring transactions to take advantage of the differences in tax treatment.

The timing of income recognition for both options and contingent debt instruments should be refined. The mark-to-market regime is probably not politically viable, nor does it offer a solution for taxing privately traded property. However, imputing interest income to all options and contingent debt instruments at the AFR could be implemented. The amount paid for the option or contingent debt instrument would be the principal upon which interest accrues. If we are determined not to tax contingent payment obligations until the contingency is resolved, we should at least recognize that income from investments held in straddles is essentially locked-in. The system should determine the yield to maturity of the combined investments and impute OID income at that rate to the holder. Regardless of which approach is adopted, it should be applied uniformly to options and contingent debt instruments.

Income should be characterized more consistently for all contingent payment obligations. Interest accrued on the contingent payment obligation or on two investments in a straddle should be ordinary income to the holder. Correspondingly, the issuer should receive ordinary interest deductions in the same amount. All other gain or loss should be treated as capital in nature.

By implementing any one of these proposals, the system would take a step forward in the direction of improving the taxation of contingent payment obligations. Each step that brings us closer to treating contingent payment obligations correctly and consistently eliminates opportunity for exploiting the problems in the current system and improves the ability of the tax base to withstand erosion from the rapid development of new contingent payment instruments.

RECENT DEVELOPMENTS

THE HIGHER EDUCATION AMENDMENTS OF 1992: RESOLVING THE CONFLICT OVER DIVERSITY STANDARDS AND INSTITUTIONAL ELIGIBILITY FOR TITLE IV AID

The Higher Education Act of 1965 ("HEA") established the major federal programs to support postsecondary education and to assist financially needy students.[1] The heart of the Act, Title IV, "Student Assistance," provides aid to students in the form of student loans (Guaranteed Student Loans, Perkins Loans), grants (Pell Grants, Supplemental Educational Opportunity Grants), work study assistance, and fellowships. In the 1990–91 academic year, the federal government provided over $18 billion to approximately 6 million eligible students attending over 8000 institutions of higher education through Title IV. These institutions include public and private, profit and non-profit, secular and religiously affiliated colleges and universities, as well as community colleges and proprietary and vocational-technical career schools.[2]

In order to be eligible to receive federal aid, an institution of higher education must be accredited by an accrediting agency that has been recognized by the Secretary of Education as a reliable authority on educational quality. Accrediting agencies are private organizations made up of institutions of higher education that are related either by geography (for example, all schools in the Mid-Atlantic region) or by their institutional "mission" (for example, Bible colleges or women's colleges). An association develops standards for measuring educational quality based upon a consensus of the member educational institutions. It then grants or denies accreditation to member institutions based upon an evaluation of each individual institution's achievement of those standards.

Congress required accreditation by private accrediting agencies for eligibility for federal student aid to ensure that schools that receive federal funds are high quality institutions rather than simply "diploma mills." By having private organizations evaluate "quality," the Department of Education does not have

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[1] 20 U.S.C. § 1070 (1988).

[2] MARGOT A. SCHENET, HIGHER EDUCATION: REAUTHORIZATION OF THE HIGHER EDUCATION ACT 1 (1992).

to develop its own standards for measuring educational quality. Congress specifically prohibited federal control over local educational policy,[3] and prohibited the Secretary of Education from exerting control over the policies of either educational institutions or accrediting agencies.[4] Thus, Congress has given private accrediting agencies a significant amount of power over institutions of higher education, but has retained very little power to control these agencies in accordance with a philosophy that favors local control of education.

In early 1990 a controversy over the use of diversity standards by an accrediting agency led to a public debate over the propriety of private institutions controlling access to federal funds. The Middle States Association of Colleges and Schools, a regional accrediting agency, withheld the reaccreditation of both the Westminster Theological Seminary and Bernard M. Baruch College for failing to comply with standards requiring diversity of faculty and governing board membership. Learning of this use of diversity standards, Secretary of Education Lamar Alexander delayed renewing Middle States' federal recognition. What followed was a heated dispute about whether an accrediting agency's diversity standards should constitute a basis for federal aid eligibility.[5] Also hotly debated was the issue of whether the Secretary of Education had the statutory authority to deny renewal of recognition to an accrediting agency based upon the agency's substantive standards.

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[3] 30 U.S.C. § 3403(a) (1988).

[4] 30 U.S.C. § 3403(b).

[5] *Compare* Jim Sleeper, *The Policemen of Diversity: How the Middle States Accreditors Threaten Academic Freedom*, WASH. POST, June 30, 1991, at C1 ("In its pursuit of diversity, Middle States not only overstepped a member-driven consensus by using the club of federal aid, but by doing so it politicized a peer-evaluation process that academics have tried to safeguard from outside influence ever since McCarthyism pushed its political nightmares upon universities.") *and* George F. Will, *Poisoning Higher Education*, WASH. POST, Apr. 21, 1991, at B7 ("Restricting institutional autonomy, circumscribing individual freedom and imposing intellectual uniformity is the explicit political agenda of groups making diversity demands.") *with* Kenneth J. Cooper, *Alexander Questions College 'Diversity Standard'; Education Secretary Sees Danger of Hiring Quotas Rising from Accreditation Procedure*, WASH. POST, Apr. 13, 1991, at A4 ("Robert H. Atwell, president of the American Council of Education . . . said the questioning of 'diversity standards' is reminiscent of the Department's challenge last year of minority scholarships. 'For me, diversity is a defensible ingredient to educational quality and thus defensible as an accreditation standard,' Atwell said.") *and* Patricia McGuire, *Policemen of Diversity?*, WASH. POST, July 17, 1991, at A22 ("[T]he so-called diversity principles are designed to ensure a fundamental ethical premise—namely that colleges and universities are accountable to deliver on the educational promises we make when we admit our students.").

The controversy represented more than a clash between conservatives and liberals over multiculturalism. It reflected a fundamental conflict over the appropriate role for accrediting agencies. The goals accrediting agencies set for themselves—to promote educational quality through compliance with peer-established criteria, including diversity standards—differ from the more limited goals that the federal government has set for accreditation—to ensure that schools are not diploma mills.[6]

In response to this controversy, Congress added several sections to the Higher Education Amendments of 1992[7] to prevent the Secretary of Education from exerting control over the standards used by accrediting agencies and to specifically allow accrediting agencies to adopt any standards they deem appropriate.[8] Congress created an exception for religious schools. The Secretary of Education may continue to recognize a religiously affiliated school that has been denied accreditation if the Secretary believes the denial was based upon standards that conflict with the school's religious mission.[9]

This Recent Development will examine the controversy that led Congress to add these sections to the Higher Education Amendments of 1992 ("the Amendments") and will discuss possible consequences of the Amendments. Part I briefly describes the HEA's accreditation requirements. Part II recounts the circumstances of the controversy over diversity standards. Part III explains the relationship between the accrediting agencies and the federal government. Part IV addresses the ambiguity regarding the Secretary's authority to control accrediting agency standards, and Part V contains the legislative history of the final provisions of the Amendments. Part VI focuses on the implications of this controversy and its legislative resolution for the continued autonomy of accrediting associations and for future

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[6] This conflict is not a recent phenomenon:

> Accreditation standards reflect the needs of the member institutions and accrediting associations (which is quite proper). These differ sharply from the needs of Federal program administrators who need to determine eligibility. Accreditation is or should be a private, voluntary activity. It is unreasonable to ask the accrediting agencies to undertake tasks on behalf of the federal government for which it has been unwilling to pay or provide other support.

G. Arnstein, Institutional Eligibility—Toward a National Board of Eligibility (Nov. 1976) (Student Financial Assistance Study Group Working Paper), *cited in* Courts Oulahan, *The Legal Implications of Evaluation and Accreditation*, 7 J.L. & EDUC. 193, 196 n.14 (1973).

[7] Pub. L. No. 102-325, 106 Stat. 448 (1992).

[8] *Id.* § 496(g), (n).

[9] *Id.* § 496(k).

conflicts between the Secretary of Education and accrediting agencies over standards. Part VI also notes the possible Establishment Clause problems with the allocation of federal funds through Title IV aid to religiously affiliated schools and with the new "Religious Institution Rule."

I. The Higher Education Act and the Accreditation Process

In order for an institution of higher education to receive federal Title IV funds under the HEA, or for students attending such an institution to receive federal student loans, the institution must be accredited by an agency recognized for that purpose by the Secretary of Education ("the Secretary").[10] To facilitate the accreditation requirement, Congress has directed the Secretary of Education to "publish a list of nationally recognized accrediting agencies or associations which he determines to be reliable authority as to the quality of training offered."[11] The Secretary receives advice regarding the recognition of agencies from the National Advisory Committee on Accreditation and

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[10] The definition of "institution of higher education" includes "an educational institution in any State which . . . (5) is accredited by a nationally recognized accrediting agency or association approved by the Secretary for this purpose." 20 U.S.C. § 1085(b). Prior to the 1992 Amendments, institutions not accredited but meeting one of two statutory exceptions could also receive federal student aid. These exceptions were:

> (A) . . . an institution with respect to which the Secretary has determined that there is satisfactory assurance, considering the resources available to the institution, the period of time, if any, during which it has operated, the effort it is making to meet accreditation standards, and the purpose for which this determination is being made, that the institution will meet the accreditation standards of such an agency or association within a reasonable time; or (B) . . . an institution whose credits are accepted on transfer by not less than three institutions which are so accredited, for credit on the same basis as if transferred from an institution so accredited.

Id. The 1992 Amendments eliminated these exceptions. However, the Department of Education's Appropriations Act, which was passed October 7, 1992, included an amendment to the Higher Education Amendments restoring an exception similar to (A). Institutions which have "been granted preaccreditation status by . . . an agency or association that has been recognized by the Secretary" and which are expected to "meet the accreditation standards of such an agency within a reasonable time" may also receive Title IV aid. Department of Labor, Health and Human Services and Education, and Related Agencies Appropriations Act of 1993, Pub. L. No. 102-394, § 308(a), 1992 U.S.C.C.A.N. (106 Stat.) 1792, 1820. Furthermore, 20 U.S.C. §§ 1082, 1088, 1094, and 1141 enumerate additional requirements including that the institution has been licensed or otherwise authorized by the state in which it is located and that it has been deemed "eligible and certified" by the Department of Education. To determine eligibility, the Department reviews the school's compliance with regulatory criteria regarding financial responsibility and administrative capability. *Id.* §§ 1082, 1088, 1094, 1141.

[11] 20 U.S.C. § 1088(b) (Supp. II 1990).

Institutional Eligibility ("the Advisory Committee").[12] Section 1088(b) is the only provision of the HEA that gives the Secretary any authority over accrediting agencies.

Pursuant to this vaguely defined authority, the Secretary has promulgated regulations delineating the standards and procedures by which an accrediting agency must abide to receive and retain recognition.[13] These criteria are primarily procedural, not substantive, and are drawn to ensure that accrediting agencies meet standards of due process in evaluating member institutions. Under these regulations, in order to be recognized by the Secretary, an accrediting agency must (1) be experienced in its geographical area and in the programs it seeks to accredit;[14] (2) be national or regional in scope;[15] (3) make publicly available the objectives, criteria, procedures, and standards used for evaluating institutions;[16] (4) establish procedures for fair review of complaints about its decisions;[17] (5) provide advanced public notice of changes in criteria, inviting interested parties to comment;[18] (6) have sufficient resources to carry out its functions;[19] (7) require self-analysis by member institutions and conduct on-site reviews of institutions;[20] and (8) base its decisions upon its published criteria.[21]

In addition, under the regulations, an accrediting agency's policies, evaluation methods, and decisions must be accepted throughout the United States by educators, licensing bodies, and other practitioners;[22] its organization, functions, and procedures must include controls against "inconsistent application of its criteria and standards";[23] and it must obtain and consider information on the effectiveness, as measured by student achievement, of the postsecondary educational institutions it accredits.[24] Newly formed accrediting agencies must apply to the Secretary for recognition, and currently recognized agencies

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[12] 34 C.F.R. § 602.4 (1991).
[13] *See id.* § 602. These regulations are invalidated by the 1992 Amendments.
[14] *Id.* § 602.4.
[15] *Id.* § 602.12(a).
[16] *Id.* § 602.13(a), (d)–(e).
[17] *Id.* § 602.16(e).
[18] *Id.* § 602.16(c).
[19] *Id.* § 602.15.
[20] *Id.* § 602.16(a)(1)–(2).
[21] *Id.* § 602.16(c).
[22] *Id.* § 602.14.
[23] *Id.* § 602.16(g).
[24] *Id.* § 602.17.

must apply for renewal of recognition at least once every five years.[25]

In establishing the Department of Education, however, the Congress stated its specific intent to reserve responsibility for education to state and local school systems,[26] and specifically forbade the Secretary from exerting control over either institutions of higher education or accrediting agencies:

> No provision of a program administered by the Secretary . . . shall be construed to authorize the Secretary . . . to exercise any direction, supervision or control over the curriculum, program of instruction, administration or personnel of any educational institution, school or school system, [or] over any accrediting agency or association . . . except to the extent authorized by law.[27]

The conflict between accrediting agencies and the Secretary arose over whether the provision requiring the Secretary to recognize accrediting agencies constituted authority to determine what standards an accrediting agency may use—in this case, to determine whether diversity is an appropriate standard for an accrediting agency to use in measuring educational quality.

II. Questioning the Use of Diversity as a Standard for Evaluating Quality of Higher Education Institutions

In April 1991, just one month after his appointment to office, Secretary of Education Lamar Alexander, on the recommendation of the Advisory Committee, placed on hold the renewal of recognition of the Commission on Higher Education of the Middle States Association of Colleges and Schools ("Middle

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[25] *Id.* § 602.3.

[26] "The establishment of the Department of Education shall not increase the authority of the Federal Government over education or diminish the responsibility for education which is reserved to the States and the local school systems and other instrumentalities of the states." 20 U.S.C. § 3403(a). A similar prohibition against federal control of education appears in 42 U.S.C. § 298a (1991) (nursing education).

[27] 20 U.S.C. § 3403(b).

States").[28] Secretary Alexander specifically questioned whether the diversity of a college's student body or faculty was an appropriate measure of educational quality, warning that "prescriptions of racial and gender balances for colleges could undermine academic freedom, threaten distinctive colleges and create racial hiring quotas."[29] In a memorandum of his decision to remand Middle States' petition for renewal of recognition to the Advisory Committee, the Secretary referred to diversity standards as "coercive restrictions" and warned that their use to encourage "'appropriate' ethnic, racial, gender, and age diversity or balance among the faculty and governing board of an institution as a condition for accreditation" could "conceivably cause violations of federal civil rights laws by . . . leading to race-based hiring quotas."[30]

Specifically, the Secretary questioned the standards on three pages of Middle States' *Characteristics of Excellence in Higher Education*.[31] Although he did not specify the standards to which he objected, the following "diversity standards" appeared on those pages: (1) "[A]n institution must . . . have a governing board which includes a diverse membership broadly representative of the public interest and reflecting the student constituency";[32] (2) "Steps must also be taken to achieve appropriate

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[28] Middle States describes itself as a "voluntary membership organization [of] educational institutions located in New York, New Jersey, Pennsylvania, Delaware, Maryland, and the District of Columbia, Puerto Rico, the Virgin Islands, and several overseas locations." COMMISSION ON HIGHER EDUCATION, MIDDLE STATES ASSOCIATION OF COLLEGES AND SCHOOLS, PUBLICATION NO. 1005, WHAT IS ACCREDITATION? 2 (1991). It is one of six regional accrediting agencies nationwide and is primarily responsible for reviewing all institutions in its region to determine eligibility for accreditation. The Commission on Higher Education has four stated purposes:

> (1) to evaluate institutions of higher education based on standards developed by the colleges and universities in our membership; (2) to accredit those institutions which meet the standards for accreditation; (3) to assist institutions in as many ways as possible to improve their programs and services; and (4) to work closely with other organizations in promoting educational improvement.

Id. at 15–16. The 24-member Commission is elected by the Middle States constituency from active faculty and staff of member institutions. *Id.*

[29] Cooper, *supra* note 5 at A4.

[30] Lamar Alexander, Decision of the Secretary of Education Remanding Petition for Renewal of Recognition of the Commission on Higher Education of the Middle States Association of Colleges and Schools 2–3 (Apr. 11, 1991) (on file with the *Harvard Journal on Legislation*) [hereinafter Alexander's Decision].

[31] *See id.* at 2.

[32] COMMISSION ON HIGHER EDUCATION, MIDDLE STATES ASSOCIATION OF COLLEGES AND SCHOOLS, PUBLICATION NO. 1000, CHARACTERISTICS OF EXCELLENCE IN HIGHER EDUCATION: STANDARDS FOR ACCREDITATION 1 (1990). These standards were revised after the Secretary's decision. *See infra* note 104 and accompanying text.

diversity of race, ethnicity, gender and age in faculty ranks";[33] (3) "Members [of the board] should represent different points of view, interests, and experiences as well as diversity in age, race, ethnicity, and gender."[34]

The Secretary's actions resulted from two cases in which Middle States had deferred reaccreditation of institutions failing to meet these diversity standards.[35]

A. *Women on the Governing Board of Westminster Theological Seminary*

The Westminster Theological Seminary is a small Presbyterian-affiliated college in Pennsylvania. In 1989, Middle States deferred the reaccreditation of the Seminary because no women were members of its governing board, although women constituted ten percent of the student body. Westminster protested this ruling on the grounds that the Seminary's charter requires board members to be ordained ministers, but the conservative Presbyterian sponsorship of the school does not allow women to be ordained. They felt that the imposition of Middle States' standard threatened the school's religious freedom and its academic freedom to determine who should sit on its board. Middle States granted reaccreditation in the summer of 1991 when the Seminary agreed to include women on board committees, but not as voting members of the governing board.[36]

B. *Minority Faculty Representation at Bernard M. Baruch College*

Bernard M. Baruch College, part of the City University of New York, is a racially diverse institution (approximately 21% white, 20% African-American, 60% other minority groups)[37] located in Manhattan. In 1990, Middle States deferred reaccreditation of Baruch College for three months due to "high attrition

[33] *Id.* at 25.
[34] *Id.* at 32.
[35] Deferment does not affect eligibility for federal aid, but it does threaten the loss of funds and may also seriously damage the reputation of an institution, thus reducing its student enrollment or devaluing its graduates' diplomas.
[36] *See* Kenneth J. Cooper, *Campus Diversity: Is Education Dept. Interfering on Standards?*, WASH. POST, Sept. 17, 1991, at A17; Sleeper, *supra* note 5, at C4.
[37] Cooper, *supra* note 36, at A17.

among minority students, racial tensions and low percentages of minority faculty and administrators."[38] Baruch's president at the time, Joel Segall, attributed the persistence of these problems to the school's decision to focus its limited resources on its business school, arguing that the business school's "allure for top corporate recruiters was" the college's "best contribution to minorities."[39] Middle States, however, insisted that Baruch address student retention and minority-faculty recruitment problems or risk losing its accreditation. Shortly thereafter, an African-American dean was promoted to the vice-presidency, and Segall, who resigned, was replaced by an African-American acting president.[40] Baruch was eventually reaccredited.

C. *Conflicting Images of Diversity*

The Westminster and Baruch cases generated a heated controversy between those who believe diversity standards threaten academic freedom and lead to "quotas," and those who believe that the decision to use such standards is protected from governmental scrutiny by principles of academic freedom and that diversity is an important measure of educational quality. Secretary Alexander feared specifically that diversity standards might interfere with colleges' academic freedom, decrease real diversity among colleges and universities, and, in cases such as Westminster, threaten religious freedom.[41] He also expressed this concern in his testimony before Congress at a hearing about the Middle States controversy:

> [T]he [S]ecretary has never asked the accrediting agencies . . . to try to interfere with the religious beliefs of people attending one of those colleges or universities. We have not sought to ask a private accrediting agency to tell Howard University how many Anglo Americans ought to be on its board, or to tell Jewish Theological Seminary how many Presbyterians ought to be on its faculty or on its board.[42]

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[38] *Id.*

[39] Sleeper, *supra* note 5, at C4.

[40] *Id.*

[41] Alexander's Decision, *supra* note 30, at 2.

[42] *Civil Rights, Diversity and Accreditation: Hearing Before the Human Resources and Intergovernmental Relations Subcomm. of the House Comm. on Government Operations*, 102d Cong., 1st Sess. 15 (1991) [hereinafter *Diversity Hearings*] (statement of Lamar Alexander, Secretary of Education); *see also id.* at 25, 38, 44–45.

Secretary Alexander also feared that accrediting agencies were overstepping their bounds by requiring cultural diversity and that the use of diversity standards was a relatively new practice which needed to be stopped:

> I think I have a responsibility to consider whether the accrediting agencies ought to limit their activities—whether [they] are going too far afield when they get into a social agenda that includes cultural diversity .... As I understand it, [the diversity standard] was adopted in 1988 by the Middle States Association.[43]

Middle States disagreed. They accused Secretary Alexander of misunderstanding the accreditation process in general and Middle States in particular. The executive director of Middle States questioned "whether anyone has read the material we've supplied them," and another member of Middle States complained that Secretary Alexander "obviously misunderstands what we're doing."[44]

Middle States characterized its actions as: (1) encouraging member institutions to "implement recruitment, retention, governance and curricular programs" that are consistent with the goals already articulated by an institution in its mission statement; and (2) ensuring that the campus environment was responsive to the needs of all who are a part of it, including nontraditional students, minorities, and those with disabilities.[45] Middle States categorically denied that it had coercively imposed diversity standards and that those standards constituted quotas: "The commission has no numerical targets and eschews notions of 'political correctness.'"[46] Rather, Middle States characterized its standards as "reminders that minorities . . . should be welcomed and well-served."[47] To support these assertions, Middle States noted that accreditation was granted to colleges that restrict enrollment to women or adherents to specific faiths without asking them to change their missions or goals.[48]

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[43] *Id.* at 31, 45.
[44] Karen DeWitt, *Official Assails College Diversity Rule*, N.Y. TIMES, Nov. 22, 1991, at A21.
[45] Howard L. Simmons, *Equity Doesn't Require Quotas*, NEWSDAY, June 5, 1991, at 88.
[46] *Id.*
[47] *Id.*
[48] *Id.*

In Middle States' view, commitment to principles of diversity was not only an appropriate standard of educational quality, but an essential one:

> The commission rightly views equity and diversity as essential to academic quality, just as the American ideals of justice and fairness are essential to the integrity of all our institutions . . . . If accrediting bodies . . . were to neglect the needs of students who are dealing, sometimes for the first time, with the historical divisions within our society, we would be giving only lip service to educational quality.[49]

Middle States also contended that the diversity standards were drafted by members who were elected by their peers and who believed that "once an institution's student body becomes diverse, that institution must serve all of the admitted students."[50] In applying diversity standards, the Middle States commissioners sought "to confirm that the member institutions are fulfilling their promises to all students."[51] Middle States also asserted that a commitment to diversity as part of the accreditation process had been its policy for decades: "Commitment to [this principle] is not new for the Commission on Higher Education and long predates legislation on affirmative action."[52]

Thus, the Secretary of Education believed Middle States was abusing its power by inappropriately imposing quotas on institutions of higher education. Middle States, on the other hand, believed it was asking educational institutions belonging to its Commission on Higher Education to live up to their institutional mission statements which, in some cases, included diversity among students, faculty, and governing board members.

To better understand this debate and the implications of the 1992 Amendments for the future use of diversity standards, it is first necessary to understand accreditation and how private accrediting agencies became such an important part of the federal aid process.

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[49] *Id.*

[50] Carolyn P. Landis, *Accreditation and Politics*, WASH. POST, Feb. 17, 1992, at A28. Ms. Landis was the Acting Chair and Public Member of the Commission on Higher Education at Middle States.

[51] *Id.*

[52] Howard L. Simmons, Promoting Equity and Diversity: Challenge and Opportunity for the MSA Commission on Higher Education, Presentation Before the 1991 Annual Meeting of North Central Association's Commission on Institutions of Higher Education 1–2 (Mar. 1991) (transcript on file with the *Harvard Journal on Legislation*).

III. Accreditation and Its Relationship to the Federal Government

A. *The Ethos of Accreditation: Voluntary, Self-Regulatory, Private Associations*

Accreditation of institutions of higher education is a little understood aspect of the federal aid process. Accrediting agencies are private, voluntary organizations of higher education institutions. Accreditation began as a "voluntary effort by a small group of educational institutions to agree on standards for distinguishing a college from a secondary school," and has developed into "a complex arrangement of sponsors, practitioners and users—each with its own agenda for accreditation."[53] Accreditation is defined by the Council on Postsecondary Accreditation ("COPA") as "a system for recognizing educational institutions and professional programs affiliated with those institutions for a level of performance, integrity, and quality which entitles them to the confidence of the educational community and the public they serve."[54] Accrediting bodies are federations of educational institutions that are (1) voluntary, (2) non-governmental, (3) based on a tradition of self-regulation, and (4) reliant on evaluative techniques to achieve their primary focus—improving educational quality.[55]

The primary elements of the accreditation process are: (1) a statement by the institution of its goals and mission; (2) a self examination of the school's success at achieving those goals; (3) an on-site evaluation by a group of its peers; and (4) the accrediting commission's review of the institution's self examination report, the on-site team report, and the institution's responses to the on-site team's report to determine if the institution is meeting its own goals and the standards of the accred-

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[53] Kenneth E. Young et al., Understanding Accreditation: Contemporary Perspectives on Issues and Practices in Evaluating Educational Quality 17 (1983).

[54] Council on Postsecondary Accreditation, Directory of Recognized Accrediting Bodies 1 (1991) [hereinafter COPA Directory]. COPA describes itself as "a nongovernmental organization that works to foster and facilitate the role of accrediting bodies in promoting and insuring the quality and diversity of American postsecondary education." *Id.* at 3. Over 57 accrediting agencies are currently recognized by COPA. *Id.*

[55] *See* Young et al., *supra* note 53, at 11.

iting body and, therefore, deserves accreditation.[56] Institutions may appeal adverse decisions. Once initial accreditation has been granted, institutions must be reviewed again every five to ten years to be reaccredited.[57]

Accreditors stress that accreditation is not a black-or-white process. It is subjective and situational. The standards by which institutions are judged are constantly shifting as members of accrediting agencies debate what defines educational quality:

> Accreditation by its very nature represents a "struggle over standards." Various interest groups within the institutions contend with one another, and external organizations try to exert their influence on institutional priorities. Inevitably, accreditation not only feels the force of these pressures but also bears the brunt of criticism from those whose interests are not served.[58]

Accreditors also stress that the standards by which an individual institution is judged are integrally connected with the school's individual objectives. They focus on "two concerns: (1) educational quality defined and interpreted within the context of the institution's or program's own statement of scope and purpose as compared with similar institutions and programs, and (2) institutional integrity that the institution or program is what it says it is and does what it says it does."[59]

B. *Accreditation as a Requirement for Federal Aid*

Congress made accreditation an element of institutional eligibility for Title IV aid to ensure that this aid would go only to high quality institutions. The use of private accrediting agencies avoided the development of federal standards of educational quality, which would violate the laws prohibiting federal control of educational policy.[60] Educators claim that the Department of Education has long been trying to gain control over accreditation and educational policy through the Secretary's statutory au-

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[56] *See* COPA DIRECTORY, *supra* note 54, at 2; YOUNG ET AL., *supra* note 53, at 21.
[57] COPA DIRECTORY, *supra* note 54, at 2.
[58] YOUNG ET AL., *supra* note 53, at 15.
[59] *Id.* at 25.
[60] *See supra* notes 26–27 and accompanying text. For a comprehensive account of the history of accreditation and the federal government, see YOUNG ET AL., *supra* note 53, at 233–69. *See also* William A. Kaplin & J. Philip Hunter, *The Legal Status of the Educational Accrediting Agency: Problems in Judicial Supervision and Governmental Regulation*, 52 CORNELL L.Q. 104 (1966); Oulahan, *supra* note 6, at 193.

thority to recognize the agencies.[61] They fear that the federal government may thereby eventually take over educational institutions' autonomy. The Middle States controversy renewed this long-standing debate about the relationship between the federal government and private accrediting agencies which has resulted from this delegation of authority.

C. *The Legal Status of Accrediting Agencies*

> The educational accrediting agency is a powerful instrumentality in the United States—able, with minimal government interference, to set policies and standards in an area of vital concern to the public . . . . For all its influence, however, the accrediting agency occupies an ambiguous legal position . . . .[62]

Although this statement was written nearly three decades ago when the complex relationship between accrediting agencies and the federal government was still in its infancy, there still is not a clear consensus within the judiciary about the status of accrediting agencies. A few generalizations, however, may be made. The federal courts support the definition of accrediting institutions as non-governmental, private actors. Therefore, their activities are not considered to be state action, despite the reliance of the federal government on accreditation as a prerequisite for federal funding,[63] although at least one court has noted

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[61] *See* YOUNG ET AL., *supra* note 53, at 254; Oulahan, *supra* note 6, at 227.

[62] Kaplin & Hunter, *supra* note 60, at 104.

[63] *See* Medical Inst. of Minn. v. Nat'l Ass'n of Trade & Technical Sch., 817 F.2d 1310 (8th Cir. 1987) (holding that the agency's decision to deny reaccreditation is not attributable to the federal government even if the decision affects eligibility for government funds); Transport Careers, Inc. v. National Home Study Council & Accrediting Comm., 646 F. Supp. 1474, 1479 (N.D. Ind. 1986) ("[T]he fact that an accrediting association's decision in granting or denying accreditation may have some effect under governmental programs does not give rise to state action.") (citing Parsons College v. North Cent. Ass'n of Colleges & Secondary Sch., 271 F. Supp. 65, 70 (N.D. Ill. 1967)). In *Medical Institute*, the court rejected the approach of Marjorie Webster Junior College, Inc. v. Middle States Ass'n of Colleges & Secondary Sch., 432 F.2d 650, 658 (D.C. Cir. 1970) ("We may assume, without deciding, that either the nature of appellant's activities or the federal recognition which they are awarded renders them state action subject to the limitations of the Fifth Amendment."), *cert. denied*, 400 U.S. 965 (1970).

that it is a "close question."[64] The courts have held that accrediting associations have a common law duty as "quasi-public" associations to follow fair procedures reasonably related to their legitimate purposes and that courts have limited judicial review to ensure the procedural fairness of agency determinations.[65] The courts have also stressed the necessity of deference to the expertise of accrediting agencies.[66]

D. *The Secretary of Education and Accrediting Agencies: A Conflict over Goals*

Secretary Alexander's concern about Middle States' use of diversity standards in the accreditation process was based upon his recognition that accrediting agencies wield a significant amount of government-sanctioned power over educational institutions. Denial of accreditation results in loss of federal funding and serious detriment to reputation. The potential for abuse of this power is real. The Secretary feared accrediting agencies

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[64] Marlboro Corp. v. Association of Indep. Colleges & Sch., 556 F.2d 78, 79–80 (1st Cir. 1977) ("Whether the Commission's procedures are, as the district court held, immune from constitutional scrutiny is a close question. While it is true that there is no governmental participation in AICS . . . it appears that if AICS or an agency like it did not perform the accreditation function, 'government would soon step in to fill the void.'" (quoting Parish v. National Collegiate Athletic Ass'n, 506 F.2d 1028, 1033 (5th Cir. 1975))).

[65] *See Medical Inst.*, 817 F.2d at 1314; *Marlboro*, 556 F.2d at 79; *Marjorie Webster*, 432 F.2d at 655; Wilfred Academy of Hair & Beauty Culture v. Southern Ass'n of Colleges & Sch., 738 F. Supp. 200, 208 (S.D. Tex. 1990); North Jersey Secretarial Sch. v. Nat'l Ass'n of Trade, 597 F. Supp. 477, 479 (D.D.C. 1984). *Compare* Blende v. Maricopa County Medical Soc'y, 393 P.2d 926 (Ariz. 1964) (reasoning that, although hospitals are quasi-public, the scope of judicial review should be narrow so as not to interfere with their autonomy) *with* Falcone v. Middlesex County Medical Soc'y, 170 A.2d 791 (N.J. 1961) (holding that, because the public has a stake in the private county medical society since it affects the health and welfare of the public, the Society may not act in an arbitrary, unreasonable, or illegal manner in deciding whom they accept as medical doctors).

[66] *See Wilfred Academy*, 738 F. Supp. at 207; *Transport Careers*, 646 F. Supp. at 1482 ("There is probably no area of law where deference is as necessary as it is when a court reviews the decision of an accreditation association."); Rockland Inst., Div. of Amistad Vocational Sch. v. Association of Indep. Colleges & Sch., 412 F. Supp. 1015, 1018 (C.D. Cal. 1976) (deferring to an association's determination of the reasonableness of its standards because "the subject matter of this action is of the character that is best left to the professional judgment of those in the field of education"); *Parsons College*, 271 F. Supp. at 74 ("The public benefits of accreditation, dispensing information and exposing misrepresentation, would not be enhanced by judicial intrusion. Evaluation by the peers of the college, enabled by experience to make comparative judgments, will best serve the paramount interest in the highest practicable standards in higher education."); *Blende*, 393 P.2d at 930 ("[T]he court must guard against . . . substituting judicial judgment for that of the Society in an area where the competence of the court does not equal that of the Society.").

like Middle States would misuse their power, in the name of "diversity," to force religious schools and other institutions to make changes that were inconsistent with their religious beliefs or institutional missions:

> If [accrediting agencies] are developing a broader agenda, I don't think the Secretary should be loaning, to their broader agenda, in a monopolistic situation, the huge weapon that might deprive students of Federal grants and Federal loans. To that extent, I think I have a responsibility to consider whether the accrediting agencies ought to limit their activities—whether accrediting agencies are going too far afield when they get into a social agenda that includes cultural diversity.[67]

Since he is charged with the responsibility of publishing a list of federally-recognized accrediting agencies which are "reliable authorit[ies] as to the quality of education offered," the Secretary felt obligated to make judgments about the propriety of standards used by these agencies, taking action where necessary to prevent abuses of power. His position is well-summarized in this excerpt from his testimony before Congress:

> [T]he Department recognizes accrediting agencies and asked [sic] those agencies to tell the Department whether a college or a university is a college or university of academic quality or whether it is just a diploma mill . . . . Congress has told the Secretary in the law to look for reliable authorities of the quality of education . . . . [W]e have given them a very powerful weapon . . . . I think what we are trying to do is to ask the gatekeeper for student grants and loans to stick to its job.[68]

As noted above, accrediting associations do not view themselves as "gatekeepers for student grants and loans." Rather, they view themselves as peer-review organizations formed to encourage self-improvement through qualitative criteria and subjective judgments, as well as to ensure that institutions are achieving their individual goals and missions.[69] Also as noted above, they firmly disagree that diversity standards are tantamount to quotas:

> [I]t is an undeniable fact that not a single regional accrediting body has established "quotas" to be met by member or candidate institutions. And, because of the strong commit-

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[67] *Diversity Hearings*, *supra* note 42, at 31.
[68] *Id.* at 29.
[69] *See supra* text accompanying notes 53–59.

> ment of accrediting bodies and institutions regarding institutional autonomy, along with the emphasis on educational improvement which characterizes voluntary peer review and accreditation, it is highly doubtful that any institution anywhere in the regional accrediting network would countenance such regulation . . . . [I]t is a corresponding responsibility of the regional accrediting body to assure that each accredited and candidate institution is accountable for its missions and goals, and that its policies and practices are commensurate with those statements which rest upon essential principles of justice, equity, and the respect for human dignity of all who are legitimately a part of the campus community.[70]

It should be noted, however, that some educators and politicians were not as charitable regarding Secretary Alexander's motivations for calling into question the use of diversity standards. In his opening statement at the hearing about the Middle States controversy, the late Representative Ted Weiss (D-N.Y.) accused the Secretary of launching an attack on civil rights:

> The Secretary has invoked the ugly buzz word of the Bush administration, "Quotas." Diversity suddenly means "quotas." Equating diversity standards with quotas is an unfortunate scare tactic. The Department of Education seems to have become the bully pulpit for the White House's attack on civil rights. Earlier the Department attempted to outlaw scholarships that gave preference to minorities. Now the Department has taken its assault on civil rights a step further with its attempt to ban diversity standards.[71]

Dr. Ernest L. Boyer, President of the Carnegie Foundation for the Advancement of Teaching, indicated he was troubled by the incident, seeing it as a tactic to mark higher education as more liberal than the mainstream, which was related to a presidential attack on an atmosphere of "political correctness" on college campuses.[72]

In fact, there were some troubling circumstances surrounding the renewal of Middle States' recognition. Prior to Secretary Alexander's arrival at the Department, the Assistant Secretary for Post Secondary Education, Dr. Haynes, recommended to the Acting Secretary that Middle States' recognition be renewed. Upon his arrival, Secretary Alexander rejected that ad-

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[70] Simmons, *supra* note 52, at 10, 12.

[71] *Diversity Hearings*, *supra* note 42, at 2 (statement of Rep. Weiss).

[72] Thomas J. DeLoughry, *President's Education Record Draws Praise and Skepticism*, CHRON. HIGHER EDUC., Aug. 12, 1992, at A22.

vice and, shortly thereafter, accepted the resignation of Dr. Haynes. Secretary Alexander testified as follows: "When I came in, I talked with members of the Department about forming a team to do what I thought needed to be done. Dr. Haynes and I talked about that. He decided as a result of those conversations to resign."[73] In a memorandum supporting renewal of Middle States' recognition, Assistant Secretary Haynes stated that "[t]he responsibility of the Secretary is to recognize accrediting agencies that can attest to the quality of education provided by their membership. It is not within the scope of the Secretary's recognition process to frame an agency's standards."[74] Also, a memorandum from the Department of Education's Office of General Counsel on the Middle States case noted that the legislative history "suggests that the Government was supposed to take note of existing accrediting activities rather than to regulate those activities" and that "[t]he approach taken assumes that the Department of Education may focus on matters not included in the regulatory criteria in assessing an agency's capacity to evaluate educational quality. As a legal matter, this assumption is subject to question."[75] During congressional testimony, the Secretary indicated he would have to carefully consider the memorandum at issue before answering a question on its conclusions, not having previously considered its contents.[76]

In addition, the National Advisory Committee on Accreditation and Institutional Eligibility had initially voted to approve the petition of Middle States Association. It reversed its vote after a motion for reconsideration the following day by Dr. Richard Kunkel, a member who had voted in favor of approval the previous day. In his questions at the hearing, Representative Weiss implied that this reversal was at the urging of a senior official at the Department who was upset about diversity requirements.[77] Finally, Middle States was not shown the report on its "diversity standards," written by the Department of Education and submitted to the Advisory Committee, until one month after it was completed, and then only upon specific request. Some Middle States members also claimed Secretary

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[73] *Diversity Hearings*, *supra* note 42, at 26.
[74] *Id.* at 40.
[75] *Id.* at 41.
[76] *Id.*
[77] *Id.* at 47–51.

Alexander refused to meet with them to discuss the accreditation process.[78]

E. *Fighting Discrimination by Recipients of Federal Funds: Whose Job?*

Secretary Alexander's second major concern regarding the use of diversity standards was that accrediting agencies were inappropriately taking it upon themselves to remedy discrimination in institutions of higher education. "Certain testimony . . . suggests that CHE [Middle States] may consider its diversity standards as efforts to remedy discrimination . . . . CHE's prescription and application of its diversity standards could conceivably cause violations of federal civil rights laws by, for example, leading to race-based hiring quotas."[79] Institutions of higher education that receive federal funds are prohibited from discriminating on the basis of race, color, national origin,[80] or sex,[81] although educational institutions controlled by religious organizations may, in some cases, discriminate on the basis of sex.[82] The enforcement of these provisions is delegated to federal agencies, including the Department of Education.[83]

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[78] DeWitt, *supra* note 44, at A21.

[79] Alexander's Decision, *supra* note 30, at 3.

[80] "No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any program or activity receiving Federal financial assistance." 42 U.S.C. § 2000d (1988).

[81] "No person in the United States shall, on the basis of sex, be excluded from participation in, be denied the benefits of, or be subjected to discrimination under any education program or activity receiving Federal financial assistance." 20 U.S.C. § 1681(a).

[82] "This section shall not apply to an educational institution which is controlled by a religious organization if the application of this subsection would not be consistent with the religious tenets of such organization." *Id.* § 1681(a)(3).

[83] "Each Federal department and agency which is empowered to extend Federal financial assistance to any education program or activity, by way of grant, loan or contract . . . is authorized and directed to effectuate the provisions of section 1681 of this title with respect to such program or activity by issuing rules, regulations or orders . . . ." 20 U.S.C. § 1682. "Each Federal department and agency which is empowered to extend Federal financial assistance to any program or activity, by way of grant, loan or contract . . . is authorized and directed to effectuate the provisions of section 2000d of this title with respect to such program or activity by issuing rules, regulations or orders." 42 U.S.C. § 2000d-1.

The Secretary cited *Regents of the University of California v. Bakke*[84] to support his conclusion that "a private association like CHE is not the appropriate body to make findings of discrimination and fashion appropriate remedies" under the statutes prohibiting racial discrimination by recipients of federal funds.[85] The Court held in *Bakke* that individual institutions of education may not make autonomous decisions that "the government has any greater interest in helping one individual than in refraining from harming another" and, therefore, may not develop their own race-based admissions criteria.[86] The Court also suggested that programs to remedy discrimination against certain groups are only appropriate after a "determination by the legislature or a responsible administrative agency that the University engaged in a discriminatory practice requiring remedial efforts."[87]

While the Secretary was correct to note that the enforcement of anti-discrimination statutes is generally left to federal agencies, his citation of *Bakke* as proof that accrediting agencies may not address discrimination in educational institutions was problematic for two reasons. First, in *Bakke* the school had been using race-based quotas, allotting specific numbers of positions in the medical school class to certain designated minorities that were not open to non-minority students. It was only this kind of program that the Court found inappropriate. Second, the Secretary failed to note that the Court specifically held that diversity was a constitutionally permissible goal as long as it did not involve specific quotas:

> The fourth goal asserted by petitioner is the attainment of a diverse student body. This clearly is a constitutionally permissible goal for an institution of higher education . . . . The freedom of a university to make its own judgments as to education includes the selection of its student body . . . . In this light, petitioner must be viewed as seeking to achieve a

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[84] 438 U.S. 265 (1978). *Bakke* held that race may be considered as a factor in admissions decisions, but that a special admissions program at the University of California at Davis Medical School, which held open a given number of spaces to minority students that were not open to non-minorities, violated the Equal Protection Clause, a provision of the California Constitution, and section 601 of Title VI of the Civil Rights Act of 1964, which prohibits exclusion on the basis of race from participation in programs receiving federal financial assistance. *Id.*

[85] Alexander's Decision, *supra* note 30, at 3.

[86] *Bakke*, 438 U.S. at 309.

[87] *Id.* at 305.

goal that is of paramount importance in the fulfillment of its mission.[88]

Thus, Middle States' use of diversity standards, which do not specify numerical quotas, are constitutionally permissible under *Bakke*.

IV. The Secretary of Education's Statutory Authority to Control Accrediting Agency Standards

Beyond all of the political rhetoric, finger-pointing, and accusations, the Secretary does not have the statutory authority to control accrediting agency standards.

A. *Federal Non-Interference with Education*

As noted earlier, 20 U.S.C. § 3403(c) and (b) prohibit the Secretary from exercising broad authority over the educational policies of both institutions of higher education and accrediting agencies. Congress inteded to keep the federal government out of local educational decisions, and Supreme Court decisions have respected that intention.[89] The Court has also delineated, in the context of Title I aid to elementary and secondary schools, a very limited role for the judiciary in supervising schools' use of federal funds.[90]

B. *20 U.S.C. § 1088(b): Statutory Authority to Judge Quality?*

Congress has charged the Secretary of Education with the responsibility of publishing a list of "nationally recognized accrediting agencies or associations which the Secretary determines to be reliable authorities as to the quality of training offered."[91] The Secretary viewed this as his source of authority to dictate whether or not diversity standards are appropriate

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[88] *Id.* at 311–13.

[89] *See* Wheeler v. Barrera, 417 U.S. 402, 416 (1974) ("There was a pronounced aversion in Congress to 'federalization' of local educational decisions."), *modified*, 422 U.S. 1004 (1975).

[90] *Id.* at 423 ("It is unthinkable, both in terms of the legislative history and the basic structure of the federal judiciary, that the courts be given the function of measuring the comparative desirability of various pedagogical methods contemplated by the Act.").

[91] 20 U.S.C. § 1088(b).

measures of educational quality. The legislative history of this provision suggests that no such role was ever intended for the Secretary. In fact, the first publication of a list of "nationally recognized accrediting agencies" involved no actual review of the agencies by the Commissioner of Education (now the Secretary).[92] The president of COPA described the accrediting agencies' view of the Secretary's authority as follows:

> USOE's interest—its only legal interest—is to determine the ability of accrediting bodies to serve as "reliable authority as to quality of training." Therefore, the federal government should not, in its recognition process, be concerning itself with the details of how an accrediting association is organized or operates, if that body operates legally and can demonstrate that it is indeed able to evaluate effectively and report reliably on the educational quality of institutions or programs.[93]

In *Sherman College of Straight Chiropractic v. U.S. Commissioner of Education*,[94] the District Court held that the statutes authorizing the Commissioner of Education to determine which agencies are reliable authorities with respect to the quality of training offered "do not call for the Commissioner to pass upon the substantive standards of any accrediting agency."[95] The court cited the deposition of Commissioner of Education Ernest Boyer:

> The Commissioner responds "to professional groups that have organized themselves, that seem to have enough legitimacy to engage in self-policing, and when he becomes the educational philosopher he has overstepped the bounds" . . . . Such action would "represent unwarranted intrusion by the Federal government into the private sector of academia."[96]

Secretary Alexander's position was clearly at odds with this holding.

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[92] *See* Young et al., *supra* note 53, at 237–49 (giving a history of § 1088(b)).

[93] Oulahan, *supra* note 6, at 231.

[94] 493 F. Supp. 976 (D.D.C. 1980) (holding that the Commissioner of Education does not have the statutory authority to mediate interdisciplinary disputes between rival factions of chiropractors).

[95] *Id.* at 981.

[96] *Id.*

C. *Previously Recognized Limits on the Secretary's Statutory Authority*

The Department itself recognized the limited nature of its statutory authority under section 1088(b). In 1988, the Department held an informal rulemaking procedure to update the regulations governing recognition of accrediting agencies and "to enhance the Secretary's ability to judge those agencies that are reliable authorities as to the quality of education offered."[97] After the comment period following the notice of proposed rulemaking, the Secretary eliminated two proposed changes in response to comments suggesting that they exceeded his statutory authority. Specifically, the final rules relaxed a proposed requirement that the Secretary determine "whether an accrediting agency, in making its decisions, places substantial emphasis on the assessment of student achievement by educational institutions"[98] to an informational requirement that the Secretary determine "whether an accrediting agency, in making its accrediting decisions, systematically obtains and considers substantial and accurate information on the educational effectiveness of postsecondary educational institutions or programs, especially as measured by student achievement."[99] The Secretary noted the following in eliminating this proposed change:

> Some commentators stated that "the proposed criterion has the effect of placing departmental requirements directly upon educational institutions, which they felt the Secretary is explicitly prohibited by law from doing. They felt that the Secretary, in adopting this criterion, was directly specifying educational standards, which they again viewed as prohibited by law."[100]

Thus, the Department noted as recently as 1988 that the Secretary's authority to enhance the quality of higher education through the recognition process did not give him the authority to decide upon, set, or judge the appropriateness of particular educational standards.

Despite the weight of the legal evidence, however, the Secretary continued to insist that his review of the diversity stan-

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[97] 53 Fed. Reg. 25,088 (1988).
[98] 52 Fed. Reg. 33,908, 33,912 (1987).
[99] 34 C.F.R. § 602.17 (1991).
[100] 53 Fed. Reg. 25,088, 25,088–89 (1988).

dards was permissible since it was relevant to his basic evaluation of the "reliability" of accrediting agencies. His concern that "diversity standards . . . may undermine the reliability of accreditation decisions as basic indicators of an institution's adequacy in providing training and education"[101] was, in his view, sufficient legal authority, despite disagreement from both the accrediting community and certain members of Congress.[102]

D. *The Resolution of the Middle States Case*

The Middle States case was decided without having to resolve this question. Federal recognition was renewed for four years (instead of the usual five) after Middle States agreed to issue annual reports describing situations where accreditation is withheld on the grounds of diversity.[103] Middle States also clarified its diversity standards to assure schools that the standards are not mandatory conditions for accreditation and that each school may define diversity for itself.[104] In issuing the decision to renew Middle States' recognition, the Secretary also announced a change in Department policy to speed up the recognition period for new accrediting associations so that institutions that do not

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[101] Alexander's Decision, *supra* note 30, at 2.

[102] The following exchange at the diversity hearing illustrates this conflict:

> Mr. Weiss: What you are doing, though, is taking a very clear, explicitly stated legislative mandate as to your lack of any authority over supervision or control of any accrediting agency, and simply disregarding that because of your definition of what your rights are. I remind you, in fact, that it is Congress in passing legislation that determines what your authority is, it is not you who can make that determination yourself.
>
> Mr. Alexander: Mr. Chairman, I respect you, I respect the Congress, and I totally agree with you. And I am acting precisely under the authority Congress gave the Secretary.
>
> Mr. Weiss: Absolutely not.
>
> Mr. Alexander: Well, we have an obvious difference of opinion.

Diversity Hearings, *supra* note 42, at 40.

[103] Carol Innerst, *Alexander Takes Aim at Diversity Standards*, WASH. TIMES, Apr. 15, 1992, at A1.

[104] Specifically, the diversity standards were changed to read as follows: "To be eligible for accreditation, an institution must . . . have a governing board which includes a diverse membership broadly representative of the public interest, *consistent with institutional mission and sponsorship*," and "Members [of a board] should represent—*consistent with institutional mission and sponsorship*—different points of view, interests, and experiences as well as diversity in characteristics such as age, race, ethnicity, and gender." COMMISSION ON HIGHER EDUCATION, *supra* note 32, at 1, 32. Compare with the previous standards, *supra* note 32 and accompanying text.

wish to comply with diversity standards may more easily form new accrediting associations:

> "In the past, people have read our regulations as requiring any new accrediting association to be approved by the existing association," Mr. Alexander said. "As you might expect, that made approval of competition much more difficult. I don't read the regulations that way. New accrediting associations can develop as long as they meet high standards. What that means is if a group of universities . . . don't want to be quizzed about their diversity standards and think that's their own business, they can form a different accrediting association that focuses on academic quality rather than issues like diversity."[105]

Although Middle States acquiesced to some of the Secretary's demands, it clearly did not agree with the Secretary over the appropriateness of his intrusion in accrediting agency decisions. The Secretary hoped that the controversy would send "a signal to other accrediting agencies that the purpose of an accrediting agency is to focus on academic quality of institutions and to help institutions improve themselves."[106] David Merkowitz, spokesman for the American Council on Education, expressed his concern that the resolution of the Middle States case "does not settle what might happen to the next group that comes up."[107] Courts Oulahan, counsel for Middle States, also suggested that the Secretary's actions "raise[d] serious legal issues for private accreditation."[108]

V. Congress Responds: The Henry/Simon Compromise

Despite the "peaceful" resolution of the Middle States controversy and an apparent recent retreat of the Department in its

[105] Although the Secretary did not specify the regulation to which he was referring, 34 C.F.R. § 602.14 requires that an accrediting agency's "policies, evaluation methods and decisions are accepted throughout the United States by, as appropriate— (a) Educators and educational institutions; (b) Licensing bodies; practitioners, and employers in the professional or vocational fields for which the educational institutions or program within the agency's jurisdiction prepare their students; and (c) Recognized agencies."

[106] Innerst, *supra* note 103, at A1.

[107] *Id.*

[108] *Id.*

hostility toward diversity standards,[109] Congress sought to clarify its intent regarding the Secretary's statutory authority through the Higher Education Amendments of 1992.

A. *Title IV, Part H of the Higher Education Amendments of 1992: Program Integrity*

Part H of Title IV of the HEA contains provisions to ensure "Program Integrity" in the distribution of federal aid to institutions of higher education. The Amendments add a significant number of provisions to the original HEA that specify the standards an accrediting agency must meet to receive recognition by the Secretary—standards which were previously defined by the Secretary through informal rulemaking.[110] The Amendments to Part H contain fifteen new sections to guide the Secretary and accrediting agencies in the recognition process.[111]

Most relevant to the limits of the Secretary's authority are subsections (g), (k), (n), and (o). Subsection (g) prohibits the Secretary from adopting any standard for accrediting agencies not specifically set out in the Act and allows accrediting agencies to adopt any additional standards they see fit.[112] Subsection (k) creates an exception to subsection (g) for religious schools. It allows such a school to retain federal eligibility if it believes its accreditation has been revoked based upon standards inconsistent with its religious mission.[113] Subsection (n) prohibits the Secretary from basing his decision to recognize an accrediting agency on any standards other than those in this section of the

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[109] In May 1992 the Department recommended continuation of federal recognition of the Accrediting Commission for Community and Junior Colleges of the Western Association of Schools and Colleges, which uses diversity standards in its evaluations of institutions. "There was no threat to academic freedom or institutional autonomy," said James Daughdrill, a member of the advisory panel at the Department. *Accreditation: Panel Makes "Surprising" Recommendation*, Daily Report Card, May 13, 1992, *available in* LEXIS, Nexis Library, RPTCRD File.

[110] These regulations, 34 C.F.R. § 602 (1990), are largely invalidated by the Amendments.

[111] These are titled: (a) Standards Required, (b) Separate and Independent Defined, (c) Operating Procedures Required, (d) Length of Approval, (e) Initial Arbitration Rule, (f) Jurisdiction, (g) Limitation on Scope of Standards, (h) Change of Accreditation, (i) Dual Accreditation Rule, (j) Impact of Loss of Accreditation, (k) Religious Institution Rule, (l) Limitation, Suspension or Termination of Approval, (m) Limitation on the Secretary's Authority, (n) Independent Evaluation, and (o) Regulations. Higher Education Amendments of 1992 § 496(a)–(o).

[112] *Id.* § 496(g).

[113] *Id.* § 496(k).

Amendments.[114] Subsection (o) provides for the clarification of procedures for appeal of the Secretary's decisions should another case like Middle States occur.[115]

B. *The Henry/Simon Compromise*

The House version of subsection (g), the "Limitation on Scope of Standards," proposed by Representative Paul Henry (R-Mich.), limited the discretion of accrediting agencies to use diversity standards much more than the Senate version did:

> Nothing in this Act shall be construed to permit the Secretary to establish standards for accrediting agencies or associations which are not provided for in this section, provided that such additional standards are not applied in a manner that is inconsistent with the institution's mission or contrary to the religious beliefs espoused by the institution.[116]

Senator Paul Simon (D-Ill.), at the urging of educators including the Council on Postsecondary Accreditation, objected to this language.[117] He insisted that the conferees eliminate it in the final version of S. 1150, fearing it would undermine academic freedom. The Henry language could have had perverse effects. For example, if a Catholic college that was accredited by a regional accrediting agency reviewed all research results, publications, and lectures to ensure that they did not conflict with church doctrine, the Henry language would have prohibited the accrediting agency from withdrawing the school's accreditation on the basis of the review because applying such a standard would be inconsistent with the school's religious mission or affiliation. Or, if a Baptist college applied to an accrediting agency for schools affiliated with the Jewish faith, such as the Association of Advanced Rabbinical and Talmudic Studies, the agency might be required to accredit the Baptist school, since refusing to do so would be a decision on the basis of religious mission or affiliation.

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[114] *Id.* § 496(n).
[115] *Id.* § 496(o).
[116] Higher Education Reauthorization, S. 1150, Book 4, item 242, at 384 (on file with the *Harvard Journal on Legislation*).
[117] Letter from Kenneth L. Perrin, President, Council on Postsecondary Accreditation, to Senator Paul Simon (June 15, 1992) (on file with the *Harvard Journal on Legislation*).

The conferees sought a compromise to the Henry amendment that would both allow accrediting agencies to adopt additional standards and enable religious institutions to avoid compliance with standards that conflict with their faith. Senator Simon proposed, and the conferees adopted, subsection (g) without the language regarding religious institutions and the addition of subsection (j), the Religious Institution Rule. This compromise makes it clear that accrediting agencies may use standards beyond those provided for in the Amendments and in regulations adopted by the Secretary. If those additional standards conflict with a religious institution's faith, subsection (j) gives the institution time to find an alternative accrediting agency before it will lose its eligibility for funds. In this way, accrediting agencies are prevented from using the threat of denying Title IV funds to extract changes at religious colleges if those changes are not related to the standards specifically set out in the Amendments or other federal statutes regarding eligibility for federal aid.[118] This protects religiously affiliated colleges and universities from violations of their religious and academic freedom.

VI. Implications of the Higher Education Amendments of 1992 for Accreditation and the Flow of Title IV Funds to Religiously Affiliated Schools

A. *Delimiting the Secretary of Education's Authority*

The Amendments clearly do not allow the Secretary to deny recognition to an accrediting agency on the basis of standards not specifically set out in the HEA or the Amendments.[119] The Amendments also permit accrediting agencies to adopt any other criteria they deem appropriate for the evaluation of quality at colleges and universities, and forbid the Secretary to deny an accrediting agency recognition if it is meeting the standards set out in the Amendments.[120] As a result, the Secretary will not be able to argue that his statutory authority to determine if an accrediting agency is a "reliable authority as to the quality of training offered" empowers him to refuse to recognize an ac-

[118] *See supra* text accompanying notes 79–88.
[119] Higher Education Amendments of 1992 § 496(g), (n).
[120] *Id.*

crediting agency because of its use of diversity as a measure of quality.

B. *Constitutionality of Government Aid to Religiously Affiliated Colleges and Universities*

The future implications of the Religious Institution Rule[121] are not quite as clear. On its face, the rule addresses the Secretary's concern that accrediting agencies were misusing their power to determine eligibility for federal funds by forcing religiously affiliated colleges and universities to make changes inconsistent with their religious tenets, therefore violating their religious and academic freedom. These institutions may now seek accreditation from accrediting agencies that are receptive to their religious beliefs or organize such agencies themselves, without the risk of losing their eligibility for federal funds in the interim. The Religious Institution Rule, however, may threaten the integrity of the accreditation process more than the Secretary felt diversity standards did. If colleges and universities may now start their own accrediting agencies to avoid having to meet standards that are difficult or unpopular, then this rule, coupled with the Secretary's stated intention to recognize new agencies more readily, risks the proliferation of accrediting agencies aligned by political or religious ideology, rather than by a broad interest in educational quality. Under the old regulations, an accrediting agency's policies needed to be widely accepted. The Secretary is now apparently ready to ignore this requirement. This will make it much more difficult to determine if an accrediting agency is a "reliable authority as to the quality of training offered" and, therefore, will risk the allocation of federal funds to institutions approved by ideologically rigid and unreliable accrediting agencies.[122]

Moreover, two important (and little noted) questions underlie the controversy over the imposition of diversity standards on religiously affiliated colleges and universities: (1) to what extent

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[121] *Id.* § 496(k).

[122] In August 1991 Secretary Alexander granted recognition to the Transnational Association of Christian Schools, an accrediting agency for Christian Schools which believes in the inerrancy of Biblical authority. The Secretary's advisory board had recommended three times since 1988 that recognition not be granted. Scott Jaschik, *Rejecting Review Board's Advice, Alexander Grants Federal Recognition to Christian Accrediting Body*, CHRON. HIGHER ED., Sept. 4, 1991, at A34.

does the Free Exercise Clause protect the religious freedom of religiously affiliated colleges that receive federal funds; and (2) to what extent do the principles of religious and academic freedom protect a religiously affiliated college's right to select faculty members based upon race, sex, or religion?

The Establishment Clause of the Constitution prohibits federal funding to aid or advance religion. In the words of Justice Black: "No tax in any amount, large or small, can be levied to support any religious activities or institutions, whatever they may be called or whatever form they may adopt, to teach or practice religion."[123] In *Lemon v. Kurtzman*,[124] the Supreme Court enunciated a three-part test to judge whether statutes that appear to aid or advance religion, including programs which provide government aid to religious schools and institutions, violate the Establishment Clause. For a statute to be upheld: (1) it must have a "secular legislative purpose"; (2) "its principal or primary effect must be one that neither advances nor inhibits religion"; and (3) it "must not foster an excessive government entanglement with religion."[125] An important question underlying the diversity standards controversy is whether or not religiously affiliated colleges and universities that receive Title IV federal aid have a constitutionally protected right to religious freedom which justifies exempting them from standards applied to nonsectarian schools. The Supreme Court has upheld direct grants to religiously affiliated colleges and universities only where the schools receiving the aid were predominantly secular institutions that espouse principles of academic freedom, and only if the aid is restricted to secular purposes. Perhaps most Title IV aid, however, flows only indirectly to colleges and universities in the form of tuition payments by students receiving federal grants and loans. The Supreme Court has never reached the constitutionality of this kind of indirect aid to religious colleges.

1. Direct Government Aid to Religious Colleges and Universities

In a series of three cases decided in the early 1970s, the Supreme Court ruled that direct government aid to religiously

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[123] Everson v. Board of Educ., 330 U.S. 1, 16 (1947).
[124] 403 U.S. 602 (1971).
[125] *Id.* at 612–13.

affiliated colleges and universities does not violate the Establishment Clause if the recipient schools effectively separate academic and sectarian activities and if the aid is restricted to secular purposes. In *Tilton v. Richardson*,[126] *Hunt v. McNair*,[127] and *Roemer v. Maryland Public Works Bd.*,[128] the Court upheld funding programs that aided religious colleges because in each case the schools were predominantly secular, and the programs prohibited the use of the aid for religious purposes.[129] All three cases cited the lack of religious requirements for faculty membership as evidence that the schools were predominantly secular.[130]

The Court also emphasized that the religious schools that were receiving funds were committed to widely accepted principles of academic freedom.[131] This commitment, according to the Court, ensured that the schools were secular, academic institutions, not sectarian bodies. By focusing on the institutions' adherence to principles of academic freedom, the Court was able to distinguish aid to religiously affiliated colleges and universities from direct aid to parochial schools, which the Court found unconstitutional in *Lemon* during the same term as *Tilton*:

> The "affirmative if not dominant policy" of the instruction in pre-college schools is "to assure future adherents to a

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[126] 403 U.S. 672 (1971) (upholding federal grants to religiously affiliated colleges for construction of academic facilities, but invalidating section limiting to 20 years the obligation not to use those facilities for sectarian purposes).

[127] 413 U.S. 734 (1973) (holding that the South Carolina Educational Facilities Authority Act does not violate the Establishment Clause when it authorizes the financing of a transaction involving the issuance of revenue bonds benefiting a Baptist college).

[128] 426 U.S. 736 (1976) (upholding a Maryland statute funding any private institution of higher learning within the State which meets certain minimum criteria and refrains from awarding "only seminarian or theological degrees").

[129] *Roemer*, 426 U.S. at 755 (finding that the colleges met the *Hunt* requirements, "(1) that no state aid at all go to institutions that are so 'pervasively sectarian' that secular activities cannot be separated from sectarian ones, and (2) that if secular activities can be separated out, they alone may be funded," and, consequently, were not "pervasively sectarian"); *Hunt*, 413 U.S. at 743 ("What little there is in the record concerning the College establishes that there are no religious qualifications for faculty membership or student admission . . . [and that] there is no basis to conclude that the College's operations are oriented significantly towards sectarian rather than secular education."); *Tilton*, 403 U.S. at 687 (finding that "the evidence shows institutions with admittedly religious functions but whose predominant higher education mission is to provide their students with a secular education").

[130] *Roemer*, 425 U.S. at 757; *Hunt*, 413 U.S. at 743; *Tilton*, 403 U.S. at 686.

[131] *See Roemer*, 425 U.S. at 756 ("Nontheology courses are taught in an 'atmosphere of intellectual freedom' and without 'religious pressures.' Each college subscribes to, and abides by, the 1940 Statement of Principles on Academic Freedom."); *Tilton*, 403 U.S. at 681.

> particular faith by having control of their total education at an early age . . . . [B]y their very nature, college and postgraduate courses tend to limit the opportunities for sectarian influence by virtue of their own internal disciplines. Many church related colleges and universities are characterized by a high degree of academic freedom and seek to evoke free and critical responses from their students . . . . Since religious indoctrination is not a substantial purpose . . . there is less likelihood . . . that religion will permeate the area of secular education. This reduces the risk that government aid will in fact serve to support religious activities. Correspondingly, the necessity for intensive government surveillance is diminished and the resulting entanglements between government and religion lessened.[132]

Thus, the Court upheld the direct aid programs because the safeguards of academic freedom would ensure that government funds were not being used to support religious indoctrination or to advance religious beliefs, and these safeguards would prevent the excessive entanglement found in *Lemon.*

Tilton and *Hunt* involved federal aid for the construction of buildings at institutions of higher education, and *Roemer* involved non-categorical state aid to all private colleges. None of these cases, therefore, directly addresses the constitutionality of federal grants and loans for tuition, like those disbursed under Title IV. However, in *Smith v. Board of Governors,*[133] the Supreme Court summarily affirmed a federal court's decision that North Carolina's provision of tuition grants and scholarships directly to religious colleges for allocation to students did not violate the Establishment Clause.[134] After applying the standards expressed in *Tilton,* the district court found that since "the schools here are not pervasively religious and the students receiving assistance are not preparing for religious vocation, the grant of tuition and scholarship assistance to them is a secular use."[135] The Court's affirmation of the lower court in *Smith* suggests that schools that directly receive federal grants and loans, which are then distributed to students, must comply with the standards set out in the *Tilton* line of cases. If so, religiously affiliated colleges and universities that receive federal funds under Title IV must be predominantly secular. Under *Tilton,*

[132] *Tilton,* 403 U.S. at 685–87.
[133] 434 U.S. 803 (1977).
[134] *Id.*
[135] Smith v. Board of Governors, 429 F. Supp. 871, 878–79 (W.D.N.C., *aff'd without opinion,* 434 U.S. 803 (1977)).

the price of receiving federal funds is the secularization of the religious college. This secularization necessarily entails abdication of free exercise rights and privileges. Religiously affiliated colleges that receive Title IV funds, therefore, should not need nor qualify for the religious institution rule of the Amendments.

2. Indirect Aid to Religiously Affiliated Colleges and Universities

The Supreme Court has never considered the constitutionality of students using federal grants and loans, like those disbursed under Title IV, to attend religiously affiliated colleges and universities. Thus, it is an open question whether or not the Establishment Clause is violated when students use Title IV aid to attend religious colleges that are predominantly sectarian or do not espouse the principles of academic freedom.

Three cases suggest that indirect Title IV aid to pervasively religious schools does not violate the Establishment Clause. In *Americans United for Separation of Church & State v. Blanton*,[136] the Supreme Court summarily affirmed the district court's decision that a state program that gives funds directly to students, rather than to colleges for disbursement, does not violate the Establishment Clause, even if the students choose to use the funds at pervasively sectarian schools.[137] The district court rejected the plaintiff's argument that this kind of aid is subject to the same secular use restrictions as direct grants, because "the emphasis of the [indirect] aid program is on the student rather than the institution."[138] The court did not impose any of the *Tilton* requirements and upheld the aid program because: (1) "if religious schools indirectly benefit from such programs, this benefit is entirely incidental and subordinate to . . . legitimate secular purposes";[139] and (2) "there is no proof showing the predominance of benefits to one religious group."[140] By summarily affirming *Blanton*, the Court supports the proposition that aid programs that give grants and loans directly to students

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[136] 434 U.S. 803 (1977).

[137] *Id.*

[138] Americans United for Separation of Church & State v. Blanton, 433 F. Supp. 97, 104 (M.D. Tenn., *aff'd without opinion*, 434 U.S. 803 (1977)).

[139] *Id.* at 103-04 (quoting *Wolman v. Essex*, 342 F. Supp. 399, 412 (S.D. Ohio), *aff'd*, 409 U.S. 808 (1972)).

[140] *Id.* at 103.

who then choose to use them at religious schools do not violate the Establishment Clause.

In *Witters v. Washington Department of Services for the Blind*,[141] the Supreme Court upheld the use of a state grant by a blind man to pay for his tuition at a Christian college where he was learning to become a pastor, missionary, or youth director because "the fact that aid goes to individuals means that the decision to support religious education is made by the individual, not by the State."[142] Similarly, in *Mueller v. Allen*,[143] the Court upheld a state income tax deduction provided to all parents for expenses incurred in providing tuition, textbooks, and transportation for their children to elementary and secondary school because the tax deduction was available to all parents, and benefits flowed to religious schools only as a result of choices made by individuals: "The historic purposes of the [Establishment C]lause simply do not encompass the sort of attenuated financial benefit, ultimately controlled by the private choices of individual parents, that eventually flows to parochial schools from the neutrally available tax benefit at issue in this case."[144] Thus, *Blanton*, *Witters*, and *Mueller* together suggest that Title IV grants and loans given to students may be used to attend religious schools, even when the student intends to pursue a course of study in preparation for a religious vocation, as long as the aid is given directly to the individual and as long as it is offered to all students.[145]

These cases, however, do not ensure the constitutionality of Title IV aid flowing through students to pervasively religious schools. While *Blanton* was summarily affirmed, it is not binding precedent on the Supreme Court and could be overruled by a hearing on the merits of a case on point. *Mueller* and *Witters* are distinguishable and may be limited to their facts. The state

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[141] 474 U.S. 481 (1986).
[142] *Id.* at 488.
[143] 463 U.S. 388 (1983).
[144] *Id.* at 400.
[145] The Court recently granted certiorari to review a Ninth Circuit case holding that providing a state-paid sign language interpreter to a deaf student attending a sectarian high school violates the Establishment Clause. Zobrest v. Catalina Foothills Sch. Dist., 963 F.2d. 1190 (9th Cir. 1992), *cert. granted*, 61 U.S.L.W. 3256 (U.S. Oct. 5, 1992) (No. 92-94). If the Supreme Court reverses the Ninth Circuit, the principles of *Witters* and *Mueller* may be strengthened and the constitutionality of indirect Title IV aid to religious schools will be more certain. If the Court affirms, it may undermine the principles of these cases and cast more doubt on the constitutionality of indirect Title IV aid to religious schools.

aid in *Mueller* was in the form of tax deductions, a much more indirect and attenuated benefit than direct grants from the government. The state aid in *Witters* was one grant, to one student, at one religious school—a very different situation from the consistent use of large amounts of Title IV aid over time by many students attending many religious schools. Importantly, the Court suggested in *Witters* that, if petitioners could show that, as applied, the aid program resulted in a significant portion of government funds flowing to religious education or pervasively sectarian institutions, it might be held unconstitutional.[146] Thus, even if indirect Title IV aid to religious schools does not on its face violate the Establishment Clause because it is given to students directly and is available to all students whether they attend religious schools or not, it might violate the Establishment Clause if a "significant portion" of the total disbursement of the Title IV aid went to pervasively sectarian schools.

Two other cases suggest that indirect government aid is not distinguishable from direct aid if the indirect aid ultimately flows to sectarian schools. In *Committee for Public Education & Religious Liberty v. Nyquist*,[147] the Court struck down a state tuition reimbursement plan for parents of children attending private elementary and secondary schools.[148] The Court noted that "the fact that aid is disbursed to parents rather than to the schools is only one among many factors to be considered."[149] The Court invalidated the program because the reimbursements constituted a direct subsidy of religion with taxpayers money.[150] In *Grove City College v. Bell*,[151] the Court ruled that Title IX prohibitions on sex discrimination in education programs receiving federal funds are triggered even if the only federal aid the school receives is tuition payments from students who receive federal grants or student loans.[152] The Court noted that:

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[146] 474 U.S. at 488 ("Further, and importantly, nothing in the record indicates that . . . any significant portion of the aid expended under the Washington program as a whole will end up flowing to religious education."); *see also* Bowen v. Kendrick, 487 U.S. 589, 610 (1988) ("[A] relevant factor in deciding whether a particular statute on its face . . . advance[es] religion is the determination of whether, and to what extent, the statute directs aid to pervasively sectarian institutions.").

[147] 413 U.S. 756 (1972).

[148] *Id.*

[149] *Id.* at 781.

[150] *Id.* at 791 ("We see no answer to Judge Hays' dissenting statement below that '[i]n both instances the money involved represents a charge made upon the state for the purpose of religious education.'").

[151] 465 U.S. 555 (1984).

[152] *Id.*

(1) the language of the statute "contains no hint that Congress perceived a substantive difference between direct institutional assistance and aid received by a school through its students";[153] (2) "[t]he economic effect of direct and indirect assistance often is indistinguishable";[154] and (3) the evidence in the legislative history showed that Congress was aware that the student assistance programs established would "significantly aid colleges and universities."[155] If indirect aid constitutes significant federal support to colleges and universities and is, therefore, equivalent to direct aid for the purposes of prohibiting discrimination on the basis of sex and race, indirect aid should also be equivalent to direct aid for the purpose of Establishment Clause analysis. Thus, *Nyquist* and *Grove City* suggest that there is a strong argument for treating direct federal grants to schools and indirect federal aid received through student tuition payments as equivalent in Establishment Clause cases.

Many religiously affiliated colleges and universities today receive both direct federal grants and significant amounts of federal aid in the form of student grants and loans. Many of those schools are pervasively sectarian, have as their primary mission the inculcation of religious values, and do not espouse the principles of academic freedom.[156] It is not clear whether the channeling of federal aid to religious schools indirectly through student loans and grants is equivalent to direct federal aid to religious schools. If it is, then religious schools receiving indirect Title IV aid should be in compliance with the *Tilton* standards, i.e., they should be predominantly secular and should espouse principles of academic freedom, and the funds should be limited to secular purposes. Consequently, even schools that only re-

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[153] *Id.* at 564.

[154] *Id.*

[155] *Id.* at 566.

[156] For example, the Reverend Jerry Falwell's Liberty Baptist College received $15 million in Federal student aid last year. Yet, the Virginia Supreme Court ruled in Habel v. Industrial Dev. Auth., 400 S.E.2d 516 (Va. 1991), that Liberty could not obtain tax-exempt bonds for industrial development because the university is one where "religion is so pervasive that a substantial portion of its functions are subsumed in its religious mission." *Id.* at 519. The court noted that Liberty requires students and faculty to adhere to "specific religious doctrine" and has "compulsory attendance at six weekly services." *Id.* at 518. It also noted that "[f]aculty members were obligated to conform to Liberty's doctrinal statements in teaching their courses and publishing articles in their respective academic fields." *Id.* Finally, the court noted that the undisputed policy of the school is "the equipping of young people for evangelistic ministry in the local church." *Id.* There are, presumably, many other colleges with pervasively religious policies that are also receiving significant amounts of federal aid through Title IV grants and loans.

ceive federal aid through student tuition payments should not qualify for the Religious Institution Rule. Moreover, if indirect Title IV aid is equivalent to direct Title IV aid, no religious schools that are pervasively sectarian should be receiving any Title IV aid. To the extent that the Religious Institution Rule will make it easier for such schools to retain their federal funding or for religious schools to avoid complying with the *Tilton* standards, the Rule will facilitate the unconstitutional flow of government funds to pervasively sectarian schools. On the other hand, if indirect aid is not equivalent to direct aid and may constitutionally flow to pervasively religious schools, then the Religious Institution Rule may simply be an accommodation of the free exercise rights of religious schools.[157]

3. Academic Freedom in the Religious College: Freedom to Discriminate?

As noted earlier, the Supreme Court has cited commitment to principles of academic freedom as a prerequisite for receipt of federal funds by religiously affiliated schools.[158] During the diversity standards controversy, the Secretary implied that academic freedom protected the rights of religious schools to choose faculty and board members on the basis of religious philosophy. It is not clear that academic freedom protects this "right." The academic freedom to which the Court referred in *Tilton*, *Hunt*, and *Roemer* was not the academic freedom of an individual institution to decide that all members of its faculty or board should be members of a particular faith, sex, or political ideology. On the contrary, the academic freedom that the 1940 policy documents espoused was "the autonomy of the professor to seek the truth without institutional fetters on research, teaching and writing."[159] In *Sweezy v. New*

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[157] However, the Religious Institution Rule may itself violate the Establishment Clause. See *infra* notes 177–182 and accompanying text.

[158] *See supra* note 131.

[159] Marjorie Reiley Maguire, *Having One's Cake and Eating It Too: Government Funding and Religious Exemptions for Religiously Affiliated Colleges and Universities*, 1989 WIS. L. REV. 1061, 1102. The author argues that religious institutions have distorted the concept of academic freedom to protect themselves from judicial scrutiny. "[R]eligious institutions have begun to focus on the institutional autonomy aspect of academic freedom to the exclusion of freedom for the professor." *Id.* at 1109. If religiously affiliated colleges and universities "can define academic freedom only as institutional autonomy from any government oversight, they can use this autonomy to protect an institutional sectarianism that is incompatible with government funding." *Id.*

Hampshire,[160] the first Supreme Court case addressing academic freedom, the Court noted that "the areas of academic freedom and political expression [are] areas in which the government should be extremely reticent to tread."[161] It described academic freedom as the protection of teachers' and students' freedom to "inquire, to study and to evaluate, to gain new maturity and understanding."[162]

Hence, schools like the Westminster Theological Seminary may not claim both religious freedom and academic freedom as shields to accrediting agency diversity standards. Academic freedom does not include the institutional freedom to choose only those professors who will teach subjects according to the school's religious philosophy, nor does it include a right to discriminate on the basis of race or sex. In fact, such discrimination is illegal. Title VII of the Civil Rights Act of 1964 prohibits discrimination in employment on the basis of race, color, religion, sex, or national origin,[163] and Title IX of the Education Amendments prohibits discrimination on the basis of sex in any education program receiving federal financial assistance.[164] Although both Title VII and Title IX contain exemptions for religious organizations,[165] it is arguable that, under *Tilton*, reli-

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For a comprehensive study of the lack of clarity in the courts' definitions of academic freedom, see J. Peter Byrne, *Academic Freedom: A Special Concern of the First Amendment*, 99 YALE L.J. 251 (1989).

[160] 354 U.S. 234 (1957) (finding that professor's contempt conviction for refusal to answer questions about lectures he had delivered at a state university and about his knowledge of members of the Progressive Party violated his liberties in the area of academic freedom).

[161] *Id.* at 250.

[162] *Id.* Justice Frankfurter, concurring, argued that "[a] university ceases to be true to its own nature if it becomes a tool of Church or State or any sectional interest. A university is characterized by the spirit of free inquiry . . . . Dogma and hypothesis are incompatible, and the concept of an immutable doctrine is repugnant to the spirit of the university." *Id.* at 262–63.

[163] 42 U.S.C. § 2000e-1, -2. Section 2000(d) also prohibits discrimination on the ground of race, color, or national origin in programs receiving federal financial assistance.

[164] 20 U.S.C. § 1681(a). *North Haven Board of Education v. Bell* extended this chapter's prohibition to employment discrimination. 456 U.S. 512 (1982).

[165] Title VII contains two exemptions which would allow a religious institution to discriminate on the basis of religion: (1) the religious institution exemption, 42 U.S.C. § 2000e-1, and (2) the bona fide occupational qualification exemption, 42 U.S.C. § 2000e-2(e)(1). Title IX also exempts any "educational institution which is controlled by a religious organization if the application of this subsection would not be consistent with the religious tenets of such organization." 20 U.S.C. § 1681(a)(3). For a good discussion of the problems with allowing federally funded colleges to claim religious exemptions from Title VII requirements, see Maguire, *supra* note 159, at 1061 (arguing that religiously affiliated colleges and universities that accept federal funding are state actors whose acceptance of government funds binds them to the Supreme Court's conditions for the receipt of those funds and estops them from using religion as a defense in lawsuits).

giously affiliated schools receiving direct, and perhaps indirect, aid must be predominantly secular and therefore should not qualify for these religious exemptions. If this is true, and if academic freedom does not protect the rights of religiously affiliated colleges and universities whose religious tenets require discrimination on the basis or race, sex, or other characteristics, the only acceptable course for such institutions may be to refuse federal funds.[166] Thus, the Religious Institution Rule would be unnecessary.

C. *The Religious Institution Rule: Required Accommodation of Free Exercise or Violation of the Establishment Clause?*

The Religious Institution Rule is a congressional accommodation of the free exercise rights of religious institutions receiving federal aid under Title IV. Exemptions for religious groups from government regulation are required by the Free Exercise Clause when "inclusion in the program actually burdens the claimant's freedom to exercise religious rights."[167] During the controversy over diversity standards, the Secretary implied that religious schools' free exercise rights guaranteed them a right to exemption from accrediting agency standards that were inconsistent with some of their religious tenets. However, in *Employment Division, Department of Human Resources v. Smith*,[168] the Court held that the Free Exercise Clause gives no right to a religious exemption from a neutral law that happens to impose a substantial burden on religious groups, as long as the law is consistently applied to all of those engaging in the activity.[169] In *Lyng v. Northwest Indian Cemetery Protective Ass'n*,[170] the Court held that the Free Exercise Clause does not require the government to justify otherwise lawful actions merely because they interfere with the practice of certain religions, even when the government action might make it extremely difficult or even impossible for the group to practice its

[166] For a good discussion of the legal problems created by discrimination by religious institutions, particularly those receiving government funds, see Bruce N. Bagni, *Discrimination in the Name of the Lord: A Critical Evaluation of Discrimination by Religious Organizations*, 79 COLUM. L. REV. 1514 (1979).

[167] Tony & Susan Alamo Found. v. Secretary of Labor, 471 U.S. 290, 303 (1985).

[168] 494 U.S. 872 (1990).

[169] *Id.*

[170] 485 U.S. 439 (1988).

religion.[171] Because all institutions of higher education that receive federal funds must comply with the Amendments and with the standards imposed by accrediting agencies, the Free Exercise Clause, as interpreted in *Smith* and *Lyng*, does not mandate that Congress give religious schools an exemption from these requirements merely because compliance may conflict with some of their religious practices. However, Congress may grant exemptions for religious institutions even when the Free Exercise Clause does not require it.[172] In *Corp. of the Presiding Bishop of the Church of Jesus Christ of Latter-Day Saints v. Amos*,[173] the Court ruled that "it is a permissible legislative purpose . . . to alleviate significant governmental interference with the ability of religious organizations to define and carry out their religious missions,"[174] as long as the accommodation affords a "uniform benefit to all religions."[175] To determine if an accommodation satisfies the Establishment Clause, the Court will inquire whether "Congress has chosen a rational classification to further a legitimate end."[176]

The Religious Institution Rule provides preferential treatment to all religiously affiliated colleges and universities over nonsectarian schools. A religiously affiliated school that does not wish to comply with, for example, an accrediting agency standard requiring minority representation on its faculty, may declare that insufficient minority representation is due to its religious mission or affiliation, and the school will continue to be recognized as eligible for federal funds while applying for accreditation from a different association. A nonsectarian college with insufficient minority representation on its faculty will not enjoy the benefit of continued recognition by the Secretary until it finds accreditation elsewhere and will lose its eligibility for federal funds immediately. Whether or not this violates the Establishment Clause depends upon several factors. Under the standard in *Amos*, the exemption is acceptable if it "furthers a legitimate end." If the purpose of the Religious Institution Rule is to free religious schools from the burden of having to comply with

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[171] *Id.*
[172] For a general discussion of problems with religious exemptions from laws and regulations, see William P. Marshall & Douglas C. Blomgren, *Regulating Religious Organizations Under the Establishment Clause*, 47 OHIO ST. L.J. 293 (1986).
[173] 483 U.S. 327 (1986).
[174] *Id.* at 335.
[175] *Id.* at 339.
[176] *Id.*

regulations that make it difficult to practice their religion, it may pass this test. In the context of the diversity debate, however, the purpose of the Rule seems to be to allow religious institutions to avoid complying with diversity standards. It is unclear that this is a "legitimate end," particularly if the standard to which a religious institution objects is having to include women or minorities on its faculty or governing board. In *Bob Jones University v. United States*,[177] the Court upheld denial of tax benefits to religious schools that discriminate on the basis of race because "racially discriminatory private schools violate fundamental public policy and cannot be deemed to confer a benefit on the public."[178] The compelling governmental interest in eradicating racial discrimination in education "substantially outweighs whatever burden denial of tax benefits places on petitioners' exercise of their religious beliefs."[179] The Religious Institution Rule will presumably allow religious institutions to seek accreditation by an association that will approve of discrimination on the basis of sex, race, or other characteristics. If racially discriminatory private schools violate public policy, even when the discrimination is mandated by religious belief, then such discrimination is not a legitimate end, and the Religious Institution Rule fails the *Amos* standard for permissible accommodation.

The Supreme Court also addressed exemptions from government regulation for religious groups in *Texas Monthly v. Bullock*.[180] The Court noted that exemptions that are not required by the Free Exercise Clause must remove a "significant state imposed detriment" to the free exercise of religion, or they will be found to provide "unjustifiable awards of assistance to religious organizations" and "cannot but 'convey a message of endorsement,'"[181] in violation of the Establishment Clause. The burdens imposed on religious schools by compliance with accrediting agency standards that are inconsistent with their religious tenets have never been shown to be a significant detriment to the free exercise of religion. Thus, the Religious Institution Rule may provide an unjustifiable benefit to religion and may

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[177] 461 U.S. 574 (1983).

[178] *Id.* at 596 n.21.

[179] *Id.* at 575.

[180] 489 U.S. 1 (1989) (holding that a Texas statute granting religious publications an exemption from sales and use taxes violated the Establishment Clause and was not required by the Free Exercise Clause).

[181] *Id.* at 15.

convey a message of government endorsement of religious values, in violation of the Establishment Clause. The Court in *Bullock* also suggested that the Establishment Clause not only prevents government hostility to religion, but also requires that

> it may not place its prestige, coercive authority, or resources behind a single religious faith or behind religious belief in general, compelling nonadherents to support the practices or proselytizing of favored religious organizations and conveying the message that those who do not contribute gladly are less than full members of the community.[182]

By granting an exemption to religious schools and continuing to fund religious schools that do not comply with standards with which all other non-religious schools must comply, the Religious Institution Rule favors religion in general, compels taxpayers to support religious practices, supports the practices of religious organizations, and conveys a message that citizens should be glad that their tax dollars are supporting religious colleges. Thus, the Religious Institution Rule may also violate the Establishment Clause on these grounds.

Finally, the Religious Institution Rule requires the Secretary of Education to determine what is and is not a "religious mission or affiliation." In *Bullock*, the Court suggested that this factor alone might render the rule unconstitutional:

> [There exists an] overriding interest in keeping the government—whether it be the legislature or the courts—out of the business of evaluating the relative merits of different religious claims. The risk that governmental approval of some and disapproval of others will be perceived as favoring one religion over another is an important risk the Establishment Clause was designed to preclude.[183]

The Religious Institution Rule, as written, will require the Secretary of Education to evaluate the relative merits of various religious claims. Furthermore, his approval or disapproval of a school's claim to the exemption may be perceived as favoritism of some religious missions over others. It may therefore violate the Establishment Clause on this ground alone.

VII. Conclusion

Perhaps a better solution to the conflict over accrediting association autonomy and the use of diversity standards would be

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[182] *Id.* at 9.

[183] *Id.* at 16 (citing United States v. Lee, 455 U.S. 252, 263 (1982)).

to eliminate accreditation as a requirement for eligibility for federal funds altogether. In this way, accrediting associations could retain their institutional autonomy, and the Department of Education could rely solely on state licensing agencies and its own Division of Eligibility and Certification to ensure that institutions of higher education are of high quality and are not "diploma mills." This solution would put an end to the long-standing conflict between accrediting agencies and the federal government over the proper role of accreditation and would avoid the complications that will certainly result from the Amendments' Religious Institution Rule. Although Congress considered this step in the House version of the 1992 Amendments, it was defeated.[184]

The Amendments ensure that in the future, those accrediting agencies that wish to use diversity (or other controversial) standards will be free to do so without encroachment by the Secretary of Education. They also ensure that those schools that feel compliance with such standards is inconsistent with their religious missions will be able to seek accreditation by a different accrediting association or to form a new one, with no threat of loss of eligibility for federal funds in the interim. Unfortunately, this might foster the proliferation of accrediting agencies aligned by religious ideology rather than by widely-accepted principles of academic quality in higher education and, thus, undermine the effectiveness of accreditation. The Religious Institution Rule may also facilitate the receipt of federal aid by pervasively sectarian colleges and universities and may violate the Establishment Clause.

—Lisa P. Baar

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[184] *See* HOUSE COMM. ON EDUCATION AND LABOR, HIGHER EDUCATION AMENDMENTS OF 1992, H.R. DOC. NO. 447, 102d Cong., 2d Sess. 85–89 (1992).

PROPOSED FEDERAL STANDARDS FOR PRODUCT LIABILITY

> [W]e're going to scale back a self-inflicted competitive disadvantage . . . and as always, it's good to have you working with us rather than against us.[1]

The debate over reform of the product liability system achieved new visibility with the recent declarations of Vice President Quayle before the American Bar Association and various pro-business audiences. More recently, product liability reform became an issue in the 1992 presidential election.[2] The dissatisfaction with the current product liability system, which critics charge imposes undue financial burdens on business, deters research and development, and hinders the competitiveness of American business, has resulted in numerous federal and state initiatives to limit product liability actions.[3]

The Product Liability Fairness Act of 1991 ("the Act" or "S. 640") represents the most recent version of reform legislation.[4] Reform advocates, who had attempted to enact federal standards over the last decade, predicted the Act would pass on the eve of its defeat by fillibuster on the Senate floor.[5]

The Act enjoyed the support of Senate Republicans, some Democrats,[6] and the Bush administration. The Vice President

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[1] Vice President Dan Quayle, Address Before the American Business Conference, Fed. News Service, Oct. 1, 1991, *available in* LEXIS, Nexis Library, FEDNEW File.

[2] *See* Mark Trumbull, *Product-Liability System Under Congressional Debate*, CHRISTIAN SCI. MONITOR, Sept. 9, 1992, at 1; *Trial Lawyers: Scapegoat or Legitimate Concern*, The Hotline, Sept. 10, 1992, *available in* LEXIS, Nexis Library, HOTLINE File.

[3] Federal proposals, in addition to the Product Liability Fairness Act, include H.R. 2700, 102d Cong., 1st Sess. (1991), and H.R. 2937, 102d Cong., 1st Sess. (1991).

[4] S. 640, 102d Cong., 1st Sess. (1991). The first product liability reform bill was introduced in 1982, sponsored by Senator Robert W. Kasten, Jr. (R-Wis.) and others. S. 2631, 97th Cong., 2d Sess. (1982). The federal government first responded to the liability crisis in 1976 with the establishment of a Federal Interagency Task Force on Product Liability, followed in 1978 by the Commerce Department Task Force on Product Liability and Accident Compensation. *See* SENATE COMM. ON COMMERCE, SCIENCE, AND TRANSPORTATION, REPORT ON S. 640, S. REP. NO. 215, 102d Cong., 1st Sess. 12–13 (1991).

[5] *Liability Bill Sponsor Predicts Victory; Senate Vote Nears On Ending Filibuster*, BNA Product Liability Daily, Sept. 10, 1992, *available in* LEXIS, BNA Library, BNAPLD File. Even while expressing optimism as to the outcome of the vote on S. 640, reform supporters acknowledged that the bill's House counterpart remained blocked in the House Judiciary Committee. *Id.*

[6] Democratic co-sponsors included: Senators David L. Boren (D-Okla.), Christopher J. Dodd (D-Conn.), Donald W. Riegle, Jr. (D-Mich.), John Glenn (D-Ohio), Claiborne Pell (D-R.I.), Jay Rockefeller (D-W. Va.), Joe Lieberman (D-Conn.), and Terry Sanford (D-N.C.).

and the President's Council on Competitiveness campaigned for S. 640 even though it lacked some of the curtailments advocated by the Council.[7] Supporters of S. 640 have pledged to continue to fight for a similar bill in the next Congress.[8] Its defeat in the Senate notwithstanding, the issues raised by S. 640 seem certain to occupy the Congress for some time to come.

While federal efforts at reform remain stymied, significant reform of the product liability system continues on the state level.[9] The latest reforms sweeping the states follow a wave of changes that occurred in more than forty states in the mid-1980s.[10] Reform proposals vary widely both in scope and impact. Georgia, for example, enacted legislation that restricts punitive damages awards to the first successful plaintiff and requires that a portion of punitive damages be paid into the state treasury,[11] while Wisconsin recently considered prohibiting punitive damages for injuries resulting from experimental drugs when certain criteria are met.[12] These state reforms are relevant to the federal debate because S. 640 would operate in concert with the state changes.[13] Furthermore, if the crisis in product liability is effectively addressed at the state level, the need for federal standards may be obviated.

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[7] *Quayle Given "Consumer First" Award, Says Bureaucrats Should Get with Program*, BNA Product Liability Daily, Oct. 24, 1991, *available in* LEXIS, BNA Library, BNAPLD File. Dan Quayle supports statutory caps on punitive damages and a requirement that the losing party reimburse the winner for its legal fees. *Id.*

[8] "We will eventually get product liability insurance reform. We came very close yesterday . . . . This is the first time we approached 60 votes." Vice President Dan Quayle, Remarks on C-SPAN (Sept. 11, 1992); *see also* Bill Fay, *American Workers, Consumers, Businesses & 59 Senators Outvoted by Trial Lawyers; Product Liability Will Be Top Priority in New Congress*, PR Newswire, Sept. 10, 1992, *available in* LEXIS, Nexis Libary, PRNEWS File. Mr. Fay, Executive Director of the Product Liability Coordinating Committee ("PLCC"), an industry group favoring S. 640, announced that "America's consumers and businesses do not quietly accept today's decision, and neither does the PLCC. Tomorrow, we will continue the efforts that produced this powerful vote in the current Congress and into the 103rd Congress as well."

[9] Significant reform proposals have been introduced recently in 26 states. Search of LEXIS, Legis Library, STTRCK File (Oct. 1, 1992).

[10] James Barron, *40 Legislators Act to Readjust Liability Rules*, N.Y. TIMES, July 14, 1986, at A1.

[11] *See* Daniel B. Moskowitz, *Limiting Punitive Damages Is Difficult Task; District Court Tosses Out Reforms Made by Georgia Legislature*, WASH. POST, June 4, 1990, at E28. However, a federal court held the Georgia legislation unconstitutional. *McBride v. General Motors Corp.*, 737 F. Supp. 1563 (M.D. Ga. 1990).

[12] *See* A.B. 839, 1991–1992 Wis. Legis. (1991).

[13] The Act supersedes state law only to the extent that state law provisions conflict with the Act. *See* S. 640, 102d Cong., 1st Sess. § 103 (1991).

This Recent Development discusses the Act and the positions advanced for and against it. Part I describes the provisions of S. 640. Part II discusses the policy considerations that motivate both sides in the reform debate. Part III analyzes the more important provisions of S. 640. Finally, Part IV briefly summarizes and concludes that the proposed reforms are more appropriately addressed on the state level. It asserts that recent trends in state product liability legislation and court decisions have made federal intervention of the scope of S. 640 unnecessary.

I. THE PRODUCT LIABILITY FAIRNESS ACT

Introduced in the Senate on March 13, 1991,[14] S. 640 proposes nationwide standards for certain aspects of product liability actions brought in state and federal courts. Its counterpart in the House of Representatives, the Fairness in Product Liability Act of 1991, was introduced on July 25, 1991.[15] It boasted 159 cosponsors, 111 of whom were Republicans.[16]

Since its introduction by Senator Robert Kasten (R-Wis.), the number of cosponsors of S. 640 has grown to thirty-eight, thirty of whom are Republicans.[17] The Act was referred to the Senate Commerce, Science, and Transportation Committee ("the Committee"), which held hearings in September 1991 and favorably reported the bill to the full Judiciary Committee by a vote of thirteen to seven.[18] The Committee rejected, by a tie vote, an effort by its chairman, Senator Ernest Hollings (D-S.C.), one of the bill's major opponents, to amend the Act to require the

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[14] 137 CONG. REC. S3190 (daily ed. Mar. 13, 1991).

[15] *Id.* at H5908 (daily ed. July 25, 1991). The Fairness in Product Liability Act of 1991 mirrors the major provisions of S. 640. *See* H.R. 3030, 102d Cong., 2d Sess. (1991). It includes an exception to the proposed ban on punitive damages for claims involving drugs or medical devices approved by the Food and Drug Administration. Unlike S. 640, H.R. 3030 allows punitive damages awards when the packaging of the drug is substantially noncompliant with tamper-resistant packaging regulations.

[16] Bill Tracking Report, H.R. 3030, Oct. 10, 1992, *available in* LEXIS, Legis Library, BLTRCK File.

[17] Bill Tracking Report, S. 640, Oct. 10, 1992, *available in* LEXIS, Legis library, BLTRCK File.

[18] 137 CONG. REC. D1203 (daily ed. Oct. 3, 1991); *id.* at D1119 (daily ed. Sept. 19, 1991). The Senate Consumer Subcommittee began the hearings on September 12, 1991. They were concluded by the full committee on September 19, 1991. The House Small Business Committee also has held hearings on H.R. 3030. *Id.* at D1392 (daily ed. Nov. 7, 1991).

Secretary of Commerce to make an annual report on the impact of the legislation on the product liability insurance market.[19]

In May 1992, proponents attached the Act to a measure establishing federal procedures for voter registration in an unsuccessful effort to obtain a vote in the full Senate.[20] Further hearings were held in the Senate Judiciary Committee on August 5, 1992.[21] By unanimous consent, the Senate began debate on the bill on September 8, 1992.[22] On September 10, 1992, supporters of the Act failed to garner the votes necessary to close further debate on a motion to proceed to consideration of the bill.[23] Two subsequent cloture attempts failed the same day.[24] As a result, the 102d Congress will not vote on S. 640.

Buoyed by the close margin of defeat, supporters of S. 640 have pledged to introduce similar legislation in the next Congress. These supporters have publicly expressed confidence that the provisions of S. 640 ultimately will be enacted into law.[25] The most important features of the Act, likely to be introduced in the next congressional session, are described below.

Although the Act preempts conflicting or overlapping state rules of law governing product liability actions, it creates no new basis for federal jurisdiction.[26] Section 201 of the Act provides that claimants may include an offer of settlement in the complaint. Defendants who decline the offer must pay the claimants' attorneys' fees in the event that the verdict equals or exceeds the original settlement offer.[27] Similarly, claimants declining a defendant's settlement offer must be assessed attorneys' fees should the jury verdict be equal to or less than the settlement offer.[28] In addition to its incentives for early settlement, section 202(a) of the Act encourages parties to participate in a voluntary alternative dispute resolution ("ADR") procedure, if such a procedure is recognized under the law of the forum

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[19] *Id.* at D1203 (daily ed. Oct. 3, 1991).
[20] *Liability Measure Advocates Reveal Strategy: Will Offer Bill as Amendment to Force Vote*, BNA Product Liability Daily, May 20, 1992, *available in* LEXIS, BNA Library, BNAPLD File.
[21] 138 CONG. REC. D996 (daily ed. Aug. 4, 1992).
[22] *Id.* at S9056 (daily ed. June 26, 1992).
[23] *Id.* at S13,139 (daily ed. Sept. 10, 1992).
[24] *Id.* at S13,155.
[25] *See supra* note 8.
[26] S. 640, 102d Cong., 1st Sess. §§ 103–104 (1991).
[27] *Id.* § 201(e).
[28] Such costs cannot exceed the amount of plaintiff's economic and non-economic damages for which she receives collateral benefits. *See id.* § 201(f).

state.[29] Sections 201 and 202 penalize a party who refuses to accept a settlement offer or proposal to enter ADR.[30]

Section 302 effectively abolishes strict liability for the product seller. A claimant must show that the product that caused the harm was actually sold by the seller-defendant. A plaintiff must also show that the seller's own lack of reasonable care or breach of an express warranty was the proximate cause of the harm incurred.[31] Actions for failure to warn may be brought against a seller only if the seller failed to supply the consumer with those warnings received from the manufacturer.[32]

Section 303 allows punitive damages awards only where compensatory damages are awarded, and only then on a showing by "clear and convincing evidence" that the harm was caused by a manufacturer's or seller's "conscious, flagrant indifference to the safety of those persons who might be harmed by a product."[33] The determination of punitive damages may, at the request of the defendant, be carried out in a separate proceeding. Should the defendant opt for a separate proceeding, the Act bars any evidence "relevant only to the claim of punitive damages" from the proceedings on compensatory damages.[34] In addition, the Act establishes a defense against punitive damages for manufacturers who received approval for drugs and medical devices from the Food and Drug Administration ("FDA") and for aircraft manufacturers in compliance with the standards of the Federal Aviation Administration ("FAA").[35]

Section 304(a) establishes a uniform statute of limitations of two years in product liability actions beginning to run when the consumer discovered or should have discovered the harmful nature of the product. Actions involving capital goods are subject to a twenty-five-year statute of repose.[36]

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[29] The Act creates no new federal alternative dispute resolution device. *See id.* § 202(a).

[30] Under the settlement and ADR provisions, a court "must" award reasonable attorneys' fees unless the party declining settlement or ADR can overcome the rebuttable presumption that the refusal was in bad faith. *See id.* §§ 201(e)–(f), 202(c).

[31] *Id.* § 302(a)(1)(C), (2)(C).

[32] *Id.* § 302(b)(1)–(2). Because not all of § 302 specifies manufacturers, warnings from other general sources, such as government-ordered recalls, may also come under the Act.

[33] *Id.* § 302(a).

[34] *Id.* § 303(d).

[35] *Id.* § 303(c). An affirmative defense is also provided for certain products which, although lacking official FDA approval, are "generally recognized as safe and effective pursuant to conditions established" by the FDA. *Id.* § 303(c)(1)(B).

[36] The two-year statute of limitations in S. 640 starts to run at the time the claimant

Section 305 requires offsetting workers' compensation benefits against damages awarded a plaintiff. It also stays the action of any claimant who has filed for workers' compensation benefits until the full amount to which the claimant is entitled has been determined.[37] The right of subrogation, indemnification, or contribution by the employer or the workers' compensation insurance carrier against the manufacturer or seller is abolished unless "the claimant's harm was not in any way caused by the fault of the claimant's employer or coemployees."[38]

Section 306 of the Act abolishes joint liability for non-economic damages. Defendants can be liable only for that percentage of harm for which they have been proven responsible.[39]

Lastly, section 307 establishes a complete defense where the influence of intoxicating alcohol or drugs caused the claimant to be "more than 50 percent responsible for the accident or event" that resulted in the claimant's injury.[40]

II. Policy Justifications in the Debate over Reform

The Product Liability Fairness Act is the latest shot in a decade-long battle over the shape of this area of tort law. An understanding of the normative policy goals of the opposing sides is critical to determining the significance of the proposed procedural and substantive changes in tort law. This part examines the political and economic priorities of both sides.

The federal reforms have garnered the most support from Republicans and conservative Democrats.[41] Various pro-business organizations[42] and a number of legal scholars[43] strongly

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discovers or should have discovered "the harm and its cause," although an exception is made for persons with a legal disability. The 25-year statute of repose for claims involving capital goods begins to run at the time of the delivery to the product's first purchaser. *See id.* § 304(a), (b)(1), (b)(3)(A).

[37] *Id.* § 305(a), (c).

[38] *Id.* § 305(d).

[39] *Id.* § 306.

[40] *Id.* § 307(a), (b).

[41] *See supra* notes 16–17 and accompanying text.

[42] Among the most active of the pro-business groups has been the PLCC, "an industry group." *Senate Sets Sept. 8 Floor Debate on Liability Bill; Key Hearing to Precede Vote*, BNA Product Liability Daily, July 24, 1992, *available in* LEXIS, BNA Library, BNAPLD File.

[43] Scholars supporting the Act have included Professor Aaron Twerski of the Brooklyn Law School, Professor Kathryn Kelly of the Columbus School of Law, Catholic University, and Professor James Henderson of Cornell Law School. *See Products Liability: Hearings Before the Subcomm. on Consumer of the Comm. on Commerce, Science, and Transportation*, 102d Cong., 1st Sess. 100–06, 152–56, 181–85 (1992) [hereinafter *Hearings*].

support the Act. The overriding policy consideration for the proponents of S. 640 has been the effect of excessive awards to claimants on national economic competitiveness.[44] In particular, proponents argue that the existing liability system deters the business community from developing new products, due to a fear of expensive litigation and the potential financial devastation resulting from an adverse verdict.[45] When businesses do develop new products, proponents believe the prices must be increased to reflect high insurance premiums. Proponents call this price increase the "lawyer's tax."[46]

Proponents argue that this "lawyer's tax" harms consumers in two ways. First, consumers who buy American-manufactured products suffer a loss of spending power due to the liability-motivated price increase.[47] Second, because some consumers will seek out the most competitively priced product on the market, the price increases that are imposed to cover the costs of jury awards or liability insurance premiums ultimately translate into reduced demand for American-made products and a corresponding increased demand for foreign-made products.[48] The American economy also suffers directly as a consequence of the unemployment that follows when American manufacturers are driven out of business.[49]

Reform supporters also claim that the compensation levels afforded claimants under the existing system are unsatisfactory. Specifically, plaintiffs with large claims tend to be undercompensated, while those with small claims are overcompensated.[50]

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[44] S. REP. No. 215, *supra* note 4, at 7–10; *see also Hearings, supra* note 43, at 164–67 (statement of Peter W. Huber, Senior Fellow, Manhattan Institute for Policy Research).

[45] S. REP. No. 215, *supra* note 4, at 7–10. A related concern is that the consumer herself is harmed when the manufacturer refrains from making safety adjustments to a product. Vice President Dan Quayle, *Now Is the Time for Product Liability Reform*, BNA Product Liability Daily, March 27, 1990, *available in* LEXIS, BNA Library, BNAPLD File.

[46] *See* Quayle, *supra* note 45.

[47] *See* 138 CONG. REC. S6707 (daily ed. May 14, 1992) (statement of Sen. Connie Mack (D-Fla.)).

[48] *Id.*

[49] *See id.* at S6660 (statement of Sen. Conrad Burns (R-Mont.)); 137 CONG. REC. S16,505 (daily ed. Nov. 13, 1991) (statement of Sen. Jake Garn (R-Utah)) (alleging that product liability suits cause unemployment in airplane and ski lift manufacturing); *id.* at E2597 (daily ed. July 18, 1991) (statement of Rep. Toby Roth (R-Wis.)) (introducing H.R. 3030 and noting that "[b]usinesses are shutting their doors" as the result of increased liability insurance costs).

[50] W. KIP VISCUSI, REFORMING PRODUCTS LIABILITY 7, 52 tbl. 3.2 (1991); *see also* S. REP. No. 215, *supra* note 4, at 6; 138 CONG. REC. S12,499 (daily ed. Aug. 12, 1992) (statement of Sen. Jay Rockefeller (D-W. Va.)).

S. 640 proponents also try to capitalize on antipathy toward plaintiffs' attorneys. The plaintiffs' bar, as embodied in the American Association of Trial Lawyers ("AATLA"), is frequently invoked as one of the "powerful forces" with a "vested interest in the status quo" that stands in the way of meaningful reform of the product liability system.[51] Trial lawyers are typically portrayed as greedy[52] or heedless of the greater public interest.[53] At stake for the plaintiffs' bar are lucrative fees earned from large jury awards.[54]

It is apparent from recent debates in the Senate on S. 640 that the size of compensation for plaintiffs' attorneys under the existing system is a powerful motivation for reform. Proponents of reform have argued that attorneys' fees deprive the plaintiff of a fair percentage of compensation.[55] At the same time they have maintained that the defendant manufacturer suffers artificially inflated damage awards because the jury increases the plaintiff's award to adjust for attorneys' fees.[56]

Opponents of the proposed uniform standards are mostly Democrats.[57] Opponents have relied on the testimony of numerous scholars[58] and consumer advocates to support their position. Additionally, AATLA has opposed the Act, a fact to which the measure's proponents repeatedly draw attention.[59]

Opponents object to the Act on two main policy grounds. First, establishing federal standards that supersede the existing rules of law of the states violates state sovereignty. Second, the intrusion into state sovereignty will not create a uniform product liability system anyway.

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[51] *See* Quayle, *supra* note 1.

[52] *Id.*

[53] Senator Jake Garn complained that:

> [T]he Trial Lawyers Association do [sic] so well at these fishing expeditions, ambulance chasers. You see the advertisements on TV all the time: Boy, if your neck hurts, give me a call. Your attorney is only as far away as your telephone, and you do not have to pay anything unless we rip someone off.

137 CONG. REC. S16,505 (daily ed. Nov. 13, 1991) (statement of Sen. Jake Garn).

[54] "In 1990 alone trial lawyers received an estimated $13 billion in contingency fees." Quayle, *supra* note 1. Dan Quayle has indicated that the contingency fee system may be a target of future reform efforts. "There's [sic] only so many things that you can bite off at one time." *Id.*

[55] *See* Quayle, *supra* note 45.

[56] *See id.*

[57] *See supra* notes 16–17 and accompanying text.

[58] Over 70 law professors communicated their opposition to the bill to Congress. S. REP. No. 215, *supra* note 4, at 60 (views of the minority).

[59] *See, e.g.*, 138 CONG. REC. S6441 (daily ed. May 12, 1992) (statement of Sen. John C. Danforth (R-Mo.)); 137 CONG. REC. S16,505 (daily ed. Nov. 13, 1991).

Opponents call the Act "an unjustified and unprecedented usurpation of the States' authority to regulate the rights, responsibilities, health, and safety of their citizens."[60] The development of tort law has traditionally been left to state courts and legislatures, it is argued, and there must be strong reasons for Congress to disregard that tradition. Opponents of the Act do not believe that such reasons exist.[61] Even if the existing system has problems, state courts or legislatures can better address such problems. The alternative is to impose rules that are inflexible rather than uniform.[62] Should the rules fail to solve the current or future problems, Congress would have to spend more resources debating and modifying the standards.

Concern also exists about the disproportionate impact of federal standards on certain states. Senator Howell Heflin (D-Ala.) has described the bill as a "California bill" because it would preempt the tort law of Alabama more than it would preempt the tort law of either California or New York.[63] Senator Wendell Ford (D-Ky.) has objected because the provisions regarding worker's compensation offsets would cause difficulties for Kentucky's workers' compensation scheme.[64]

Each state might develop conflicting interpretations of the uniform standards and the manner in which those standards interact with state law.[65] State standards that survive preemption would continue to create a patchwork system that undermines the purported goal of the Act. For example, in the case of punitive damages awards, certain states might continue to retain damages caps, others might deny the right to sue for punitive damages unless specific statutory authority is granted, and still others might allow for punitive awards with no cap in the absence of statutory authority.

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[60] 138 CONG. REC. S6652–53 (daily ed. May 14, 1992) (statement of Sen. Richard C. Shelby (D-Ala.)).

[61] *Hearings*, *supra* note 43, at 193 (statement of Professor Andrew F. Popper, Washington College of Law, American University); *id.* at 216 (supplemental statement of the National Conference of State Legislatures); S. REP. No. 215, *supra* note 4, at 67–68 (views of the minority).

[62] S. REP. No. 215, *supra* note 4, at 67–68.

[63] 138 CONG. REC. S6650 (daily ed. May 14, 1992). Senator Heflin also noted that the supporters of uniform federal standards in product liability had previously opposed the concept of a federal workers' compensation law, as well as a federal measure that would have required consumer representation on corporate boards on grounds of federalism. Senator Heflin argued that federalism, if accepted as a guiding principle, should not be applied inconsistently. *Id.*

[64] S. REP. No. 215, *supra* note 4, at 88–89. (minority views of Sen. Ford).

[65] 138 CONG. REC. S6652 (daily ed. May 14, 1992) (statement of Sen. Richard C. Shelby).

Another claimed difficulty with the Act is that it will enable businesses to avoid responsibility for compensating the victims of defective products.[66] Opponents do not accept the dire characterizations of the existing system. Indeed, the minority on the Committee has asserted that product liability reform is "much ado about nothing,"[67] and that Congress has wasted time determining how to reform a system that has not been shown definitively to be in need of reform.[68]

Opponents recall that the purpose of the product liability system is to regulate the safety of products on the market, not to ensure that every new product is marketed regardless of its risks to consumers, and they note the success of the system in this regard.[69] They envision a system that promotes product safety through jury awards and settlements that are reasonably related to the losses of those injured.[70] Opponents contend that the burden on defendants is exaggerated to justify federal intervention on behalf of business interests.[71] Although they recognize the importance of remaining competitive in world markets, opponents disagree that product liability affects competitiveness.[72]

III. Analysis of the Proposed Legislation

A. *The Product Liability "Crisis"*

An evaluation of S. 640 depends on three questions. First, do the perceived problems with the present system exist? Second,

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[66] *See* S. Rep. No. 215, *supra* note 4, at 61 (minority view of Sen. Hollings and Sen. Albert Gore, Jr. (D-Tenn.)) (arguing that S. 640 "would add to the difficulties already faced by the victims of defective products").

[67] *Id.*

[68] *Id.*

[69] *See Hearings*, *supra* note 43, at 211–12 (statement of Ralph Nader); S. Rep. No. 215, *supra* note 4, at 66.

[70] *Product Liability Reform Act: Hearings on S. 1400 Before the Subcomm. on Consumer of the Comm. on Commerce, Science, and Transportation*, 101st Cong., 2d Sess. 203–04 (1992) (testimony of Professor Lawrence Mann, Wayne State University Law School).

[71] *House Hears Testimony on Liability Bill; Impact on Small Businesses Focus of Hearing*, BNA Product Liability Daily, June 4, 1992, *available in* LEXIS, BNA Library, BNAPLD File.

[72] Opponents concede that liability awards are significantly greater in the United States than in other industrialized nations. They emphasize, however, that these nations have other forms of compensation not available to the injured American consumer. For example, the ZW/Sick Fund law in the Netherlands compensates injured employees up to 70% of wages for one year and is funded by a five percent tax on employers' gross income and one percent of employees' gross income. S. Rep. No. 215, *supra* note 4, at 74. The minority report does not mention the existence of national health care in other industrialized nations.

does the severity of these problems warrant intrusion into an area of the law traditionally reserved for the states? Finally, how severe should liability be for unsafe products?

The existence of a products liability crisis is debatable. The report of the Committee asserts that the existing system "deprives consumers of needed products, limits job opportunities, and weakens our competitive position in world markets."[73] The minority on the Committee, by contrast, asserts that "[a]s each additional piece of objective data becomes available, it becomes more clear that the system is working."[74]

It is possible to accept simultaneously the existence of the problems that concern the majority and the minority's conclusion. While the expansion of litigation against manufacturers, the costs associated with such litigation, and the resulting increases in liability insurance premium rates may be accepted as a reality of the last decade, it does not necessarily follow that the structure of the product liability system, or the specific state rules that S. 640 would preempt, are the cause of these phenomena.

Although increasing numbers of lawsuits have affected certain industries,[75] it is unclear whether product liability has generally harmed the competitiveness of American business. Several studies refute the largely anecdotal claims of the Act's supporters that large awards increase the prices of American products, thereby leaving them vulnerable to foreign competition. These studies indicate that product liability increases the final product price by a mere one percent.[76]

Results from product liability insurance carriers also indicate that the crisis may be overstated. Although premiums written by liability insurance carriers did increase in value from $6.61 billion in 1979 to $19.08 billion in 1988,[77] virtually all of this increase is accounted for in the anomalous years, 1984 to 1986.[78] Overall, the average annual growth rate for the decade

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[73] *Id.* at 7.

[74] *Id.* at 61.

[75] *See Hearings*, *supra* note 43, at 66 (prepared statement of Dr. Deborah Hensler, Institute for Civil Justice, Rand Corp.).

[76] S. Rep. No. 215, *supra* note 4, at 71 (citing a survey of risk managers of 232 major U.S. corporations); U.S. General Accounting Office, Liability Insurance: Effects of Recent 'Crisis' on Businesses and Other Organizations (1988).

[77] Viscusi, *supra* note 50, at 26.

[78] *Id.* at 29. Viscusi attributes the unusual increase in premium volume during these two years to the drop in interest rates in 1985. Unable to rely on investment income to offset losses, insurance companies had to expand premium volume to maintain financial viability. *Id.*

1979–1988 is comparable to the growth in the preceding decade.[79]

Moreover, problems in product liability may be easing of their own accord. Numerous commentators and scholars, including Professor Aaron Twerski, a strong supporter of S. 640, have identified an emerging trend of moderation in product liability case law.[80] Other scholars have noted that asbestos-related claims actually accounted for the perceived increase in product liability filings in federal court.[81] While asbestos claims rose from 4239 in 1985 to 13,687 in 1990, other product liability filings actually decreased from 8268 to 4992 during the same period.[82] Product liability filings have increased from just over 2% of all federal civil cases in 1975 to 5.74% in 1989, the greatest increases occurring from 1978 to 1986.[83] However, product liability cases decreased slightly as a percentage of federal civil cases from 1988 to 1989.[84]

Another indication that the existing system is either self-regulating or responding to reform on the state level is the decline in plaintiff success rates in product liability actions. While supporters of S. 640 have claimed that the system moves inexorably toward more radical pro-plaintiff legal theories in a "competitive race to the bottom,"[85] a comparison of the success rates for filings over the decade 1979 to 1989 leads to a much different conclusion. In state courts plaintiff success rates declined from 55.8% in 1979 to 32% in 1989.[86] For those cases filed in federal district court and terminated before trial, plaintiff success rates declined from 50.4% in 1978 to 25.8% in 1989.[87] The rate for

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[79] *Id.* at 28.

[80] *See Hearings, supra* note 43, at 66 (statement of Dr. Deborah Hensler, Institute for Civil Justice, Rand Corp.) ("[T]here has been a remarkable turnaround in federal product liability litigation in the period since 1986."); James A. Henderson, Jr. & Aaron D. Twerski, *Stargazing: The Future of American Products Liability Law*, 66 N.Y.U. L. REV. 1332, 1342 (1991) ("The days of wretched excess are over, probably for the indefinite future.").

[81] *Hearings, supra* note 43, at 157 (testimony of Professor Marc Galanter, Institute of Legal Studies, University of Wisconsin).

[82] *Id.*; *see also* VISCUSI, *supra* note 50, at 20–24. Nor is it statistical game-playing to segregate asbestos claims from other product liability claims. As Henderson and Twerski noted, "[a]sbestos was factually unique. The dangers were hidden and the defendants arguably malevolent." Henderson & Twerski, *supra* note 80, at 1336–37.

[83] VISCUSI, *supra* note 50, at 18 tbl. 2.2.

[84] *Id.*

[85] *Hearings, supra* note 43, at 38 (statement of Justice Richard Neely, West Virginia Supreme Court of Appeals).

[86] Theodore Eisenberg & James A. Henderson, Jr., *Inside the Quiet Revolution in Products Liability*, 39 UCLA L. REV. 731, 797 app. A, tbl. A-1 (1990).

[87] *Id.* at tbl. A-2.

cases terminating after trial remained relatively constant, fluctuating from 33.6% in 1979, to a high of 40% in 1984, then dropping to 34.5% in 1989.[88]

Additionally, the amount of recovery won by successful plaintiffs has dropped considerably since the mid-1980s. The mean recovery for plaintiffs in federal courts whose cases went to trial rose sharply, from $615,000 in 1979 to $2,557,000 in 1986.[89] By 1989, that amount had fallen to $1,017,000.[90] To express this trend in a different way, the estimated sum of all product liability awards in federal district courts rose to a high of about $4.3 billion in 1985, but was $1.9 billion, less than half that amount, in 1988.[91]

This evidence suggests there may be no crisis in product liability. The growth in product liability cases may have resulted, in part, from the confluence of trends in interest rates and asbestos litigation. Furthermore, to the extent such a crisis exists, it is a phenomenon that appears to be surmountable through experimentation in legal reform in the state courts and legislatures.[92]

Even if no serious crisis exists, it may not follow that all aspects of S. 640 are without merit. However, the various reforms included in the Act do raise several questions: Will they in fact address the purported problems in the system? Will they unfairly reallocate losses from manufacturer and sellers to consumers? Is it necessary to supersede state laws in order to effectively address the issues posed by the liability crisis?

B. *Punitive Damages*

Section 303 will have the effect of reducing punitive damages awarded in states that have relatively liberal standards of proof. Section 303 may be the greatest affront to state sovereignty. The purpose of punitive damages is tied to public policy considerations which properly should be left to the determination of individual state legislatures. The punishment of certain opprob-

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[88] *Id.*
[89] *Id.* at 799 app. A, tbl. A-6.
[90] *Id.*
[91] *Id.* at tbl. A-7.
[92] *Id.* at 797–800 (contrasting trends in states with and without statutory reform); *see also* VISCUSI, *supra* note 50, at 196, 200, 205–08 (discussing the impact of state reform on product liability insurance loss ratios).

rious behavior and the deterrence of similar behavior by actors within the borders of a state has traditionally been a matter of state concern. As Senators Gore and Hollings argued, S. 640 "would alter, in one stroke, the fundamental federalism inherent in the country's tort law."[93]

The Commerce Clause of the Constitution[94] has been broadly interpreted to allow regulation of aspects of the tort system that arguably affect interstate commerce.[95] Because the health, and perhaps even survival, of certain industries depend on the shape of product liability law, it is an aspect of tort law about which Congress may constitutionally legislate. The supporters of S. 640 correctly maintain, however, that "[t]he question is not about Congress' power to enact reform, but whether it should exercise this power."[96]

By promulgating the "clear and convincing standard," S. 640 is clearly intended to limit punitive damages awards.[97] According to its supporters, it is unfair to subject business to unlimited awards.[98] Concern in the business community over punitive damages intensified after the Supreme Court decision in *Pacific Mutual Life Insurance Co. v. Haslip*.[99] In *Haslip*, the Court upheld a damages award including punitive damages four times the amount awarded for compensatory damages.[100] Although the Court accepted that the Due Process Clause may impose some limit on a punitive award, it refused to impose a bright-line rule to help juries decide where that limit lies. The refusal of the Court to set limits prompted the deputy general counsel of the National Association of Manufacturers to predict that "Congress is going to be under considerable pressure to straighten out this mess."[101]

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[93] S. Rep. No. 215, *supra* note 4, at 61 (minority view).

[94] U.S. Const. art. I, § 8, cl. 3.

[95] *See* Laurence Tribe, American Constitutional Law § 5-4 to -6 (2d ed. 1988).

[96] S. Rep. No. 215, *supra* note 4, at 12.

[97] *Hearings*, *supra* note 43, at 104 (statement of Professor Aaron Twerski) ("To inject punitive damages blithely, without carefully limiting the occasions in which courts may impose them, threatens the entire structure of product liability litigation.").

[98] *See* S. Rep. No. 215, *supra* note 4, at 36 ("The rationale for the higher standard of proof rests on fairness.").

[99] 111 S. Ct. 1032 (1991).

[100] *Id.* at 1043 ("We need not, and indeed we cannot, draw a mathematical bright line between the constitutionally acceptible and the constitutionally unacceptable that would fit every case.").

[101] *Groups Urge Congress, States to Limit Punitive Awards Following Court Ruling*, 44 Daily Rep. for Executives (BNA) A16 (Mar. 6, 1991).

However, the stronger arguments are against federal limitations on punitive damages. In any state, the current benefits of high levels of general deterrence among manufacturers and sellers may far outweigh the burden placed on business by punitive damages awards.

Moreover, the proposed adoption of uniform standards may not allow for economically efficient results. The current system has greater potential for economic efficiency because each state may adjust its punitive damages rules to reflect a desired level of deterrence, and thus avoid the overdeterrence feared by S. 640 supporters. Indeed, the recent enactment of caps on punitive damage awards in Virginia, Alabama, Georgia, Colorado, Texas, Nevada, Oklahoma, Florida, and Kansas is testimony to the willingness of states to balance the interests of business against the public interest in deterring certain behavior.[102] Instead, S. 640 would impose the requirement that the defendant's behavior be "knowingly far in excess of acceptable behavior."[103] The Committee believed that this requirement would "ensure that punitive damages are assessed only when appropriate."[104] Thus, S. 640 would prevent a state from using punitive damages to deter behavior that is only moderately in excess of acceptable behavior.

The Committee supporters of S. 640 argue unpersuasively that the federal standards will actually "enhance the deterrent effect of punitive damages."[105] The Committee majority reasoned that since large punitive damages awards are often overturned, and such reversals diminish the deterrent effect of the device, the federal government can increase the deterrent effect by reducing the number of such awards at the trial level.[106] Even if overturning a punitive damages award diminishes the deterrent effect of that award, the initial judgment (and whatever part of the

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[102] *See* Amelia Toy, *Statutory Punitive Damage Caps and the Profit Motive: An Economic Perspective*, 40 EMORY L.J. 303–40 (1991). An additional five states have banned punitive damages altogether, except where specifically authorized by statute. *See* S. REP. No. 215, *supra* note 4, at 33.

[103] S. REP. No. 215, *supra* note 4, at 35.

[104] *Id.* at 36.

[105] *Id.* at 34. The Committee majority relied on the speculation of Professor Kathryn Kelly that award reductions on appeal undercut "the kind of deterrence that we are looking for here." *Hearings*, *supra* note 43, at 187 (response of Professor Kathryn Kelly to questioning by Sen. Hollings).

[106] *See* S. REP. No. 215, *supra* note 4, at 34. Professor Michael Rustad of Suffolk University Law School testified that between 1965 and 1990, punitive awards were reduced to zero in 38.1% of the cases, and partially reduced on appeal in 18.1% of the cases. *Hearings*, *supra* note 43, at 150.

award that survives appeal) is likely to have more impact on the defendant and the business community than if no award were granted at all.

Furthermore, the majority of states require that punishable behavior be proven by a preponderance of the evidence. S. 640's proposed standard of clear and convincing evidence is favored by only twenty-two states. This fact strengthens Senator Heflin's argument that the proposed changes will disproportionately and unfairly affect certain states.[107]

The rhetoric of some of the Act's supporters suggests that a general dislike of recent large punitive awards may have prompted section 303.[108] The preferred legislative remedy, statutory caps on punitive damages, simply may not have been politically feasible.[109] Section 303 will not reduce the amount of any given award. It will simply eliminate punitive awards in certain cases, some of which may have warranted such awards but for the federal standards on burden of proof or defendant conduct.

Also disturbing is the discretion afforded the defendant to bifurcate the civil proceedings in order to segregate the punitive damages claim from other claims.[110] This provision is strangely out of place in a bill that seeks to reduce the cost of litigating claims. The real effect of segregating the punitive damages claim and related evidence from the remainder of the claim is to deny the jury the complete picture of the defendant's behavior. The result may be that the case is sanitized or artificially segregated, so that the full breadth of the wrong committed is never fully realized.[111]

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[107] S. REP. No. 215, *supra* note 4, at 33.

[108] 137 CONG. REC. E2598 (daily ed. July 18, 1991) (statement of Rep. Toby Roth) (referring to the "punitive damages sweepstakes").

[109] *See House Reform Bill Introduced by Rowland, 100 Co-sponsors*, Daily Rep. for Executives (BNA), No. 143, at A-5 (July 25, 1991) (noting that supporters of the Act hoped that the absence of caps on damages awards and limits on punitive damages would help the reform pass).

[110] S. 640, 102d Cong., 1st Sess. § 303(d) (1991).

[111] *Cf.* CHARLES A. WRIGHT & ARTHUR R. MILLER, FEDERAL PRACTICE AND PROCEDURE § 2390, at 299 (1969) (quoting *Advisory Comm. Note to the 1966 Amendments of Rule 42(b)*, 39 F.R.D. 113 (1947)). The authors discuss bifurcation of trials on the issues of liability and damages (as outlined in FED. R. CIV. P. 42), which may be analogized to the bifurcation of damages proposed in § 303. Where bifurcation was allowed, plaintiff success rates declined from 58% to 21%. The authors note that this bifurcation is not ordered routinely by the court. Rather it is subject to a case-by-case analysis that considers judicial economy and the avoidance of prejudice. *Id.*; *see also* Franklin Music Co. v. American Broadcasting Co., 616 F.2d 528 (3d Cir. 1979); Lis v. Robert Packer Hosp., 579 F.2d 819 (3d Cir. 1978), *cert. denied*, 439 U.S. 955 (1979).

Conversely, S. 640 proponents argue that bifurcation is needed to avoid prejudice against the defendant. Citing the recommendation of the American Law Institute and the American College of Trial Lawyers, which, unlike AATLA, support S. 640, proponents express concern that punitive damages will be requested in order to provide evidence of the defendant's financial resources, thereby encouraging resort to an allocation of liability based on "evidence of wealth or financial condition."[112] This argument ignores the fact that the defendant has available remedies such as judgment notwithstanding the verdict, remittitur, and appeal[113] in those cases where the jury failed to apply the appropriate standard of behavior for the award of punitive damages.

One may argue that initial bifurcation would spare the costs of appeal based on compensatory awards "tainted" by evidence applicable only to the punitive damages question, thereby justifying it as an option for a defendant. Given that the defendant will likely request bifurcation in nearly every case,[114] and that bifurcation might be accompanied by expensive appeals, it is doubtful that this process would result in any savings of judicial resources.

C. *Statute of Limitations*

Section 302 likely will have the beneficial effect of reducing the uncertainty of manufacturers, sellers, and their insurance carriers as to the duration of their exposure. The uniform statute of limitations will eliminate some otherwise viable claims. The twenty-five-year limitation on suits involving capital goods may bar a significant number of such suits, if past filing patterns are reliable indicators.[115] This may not only reduce the manufacturers' liability, but also allow liability insurance carriers to predict future losses more accurately, and to set rates accordingly. Where enacted on the state level, product liability statutes of

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[112] S. REP. No. 215, *supra* note 4, at 38.

[113] Indeed, the majority notes the effective use of the defendant appeal to overturn punitive damages awards as one reason for its approval of S. 640's burden of proof and conduct requirements. *See supra* notes 105–106 and accompanying text.

[114] The Committee majority's fear of anti-defendant prejudice would justify such an assumption.

[115] *See* S. REP. No. 215, *supra* note 4, at 84 (noting that 50% of claims against machine tool builders involve machines over 25 years old).

limitations have improved the loss ratios of product liability insurers.[116]

Section 304(b), like the sections concerning punitive damages, ADR, and regulatory compliance defense, imposes a minority rule on all fifty states. By 1991, only seventeen states had statutes of repose applicable specifically to product liability actions; the remainder use general tort statutes of limitations.[117] Nevertheless, the benefits of a uniform statute of limitations justify the slight intrusion on the state prerogative to set its own limitations period.

D. *Regulatory Compliance Defense to Punitive Damages*

The part of the Act that would provide the most direct relief is section 303(c), which would bar punitive damages awards from being entered against drugs and aircraft that meet the standards of the respective federal agencies. Senator Kasten, former Vice President Quayle, and other S. 640 proponents have highlighted the effects of the expansion of product liability on the small aircraft and pharmaceutical industries.[118] For instance, production of small aircraft declined from over 17,000 to 1085 from 1979 to 1987.[119] By 1990, both Beech Aircraft and Cessna Aircraft had discontinued the manufacture of aircraft costing less than $100,000, and sales in the industry declined by ninety percent from 1979 to 1989.[120] Some of this loss in sales has benefited foreign aircraft manufacturers.[121]

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[116] States with such statutes produced loss ratios three percent higher than those states without them, but each loss per claim was six percent higher in the states with statutes of limitations. The exclusion of certain claims under the statute of limitations mitigated the impact of the greater loss severity in these states. VISCUSI, *supra* note 50, at 200.

[117] S. REP. NO. 215, *supra* note 4, at 39–40, 84.

[118] *See* 137 CONG. REC. S16,504 (daily ed. Nov. 13, 1991) (statement of Sen. Jake Garn) (noting the case of a $1 million award against Piper Aircraft for failing to equip a small aircraft model with seat belts in the 1930s to illustrate the burdens of excessive liability). Even Dr. Deborah Hensler of the Rand Corporation, who testified against S. 640, acknowledged that the existing liability system subjects contraceptives, vaccines, and general aviation to the "pervasive effects" of diminished research and development and, thus, reduced competitiveness. *Hearings*, *supra* note 43, at 66.

[119] VISCUSI, *supra* note 50, at 8.

[120] *Id.* at 39.

[121] 138 CONG. REC. S6432 (daily ed. May 12, 1992) (statement of Sen. John C. Danforth); *see also* VISCUSI, *supra* note 50, at 40.

Section 303(c) would not spare these industries much of their continuing liability since punitive damages are rarely awarded.[122] Nevertheless, compliance with an extensive regulatory scheme should be a defense against punitive damages. Where this scheme is established by an agency with the appropriate expertise, and where the conduct required for punitive damages exceeds the standards established by this agency, it is reasonable to preclude a jury from awarding punitive damages.[123]

The argument in opposition to section 303(c) is vague and largely anecdotal. It rests on the concern that neither the Food and Drug Administration nor the Federal Aviation Administration was designed to act as the "first and last line of defense" for consumers against grossly negligent, reckless, or intentionally tortious conduct.[124] Further, it is argued that there have been "documented cases" in which the responsible agency has made errors in approving a product and that manufacturer misconduct was responsible for the continued marketing of the product.[125]

These concerns are easily addressed. Where a manufacturer has withheld material information from the relevant agency regarding hidden dangers, as in the case of the Copper 7 IUD, that manufacturer should be deemed to have maintained its agency approval through misrepresentation, thereby removing the defense provided by section 303(c).

The claim that the relevant agencies are not performing their regulatory function sufficiently to warrant leaving them as the only line of defense for drug consumers and aircraft passengers is ultimately unconvincing. Even if the Food and Drug Administration is sometimes in error and "there is room for a fifty-percent improvement from the FAA,"[126] this does not mean that these agencies are failing so severely that they cannot detect

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[122] *See* 138 CONG. REC. S6652 (daily ed. May 12, 1992) (statement of Sen. Tom Harkin (D-Iowa)); S. REP. No. 215, *supra* note 4, at 65 (minority views of Sen. Hollings and Sen. Gore) (citing studies performed by Professor Michael Rustad of Suffolk University Law School and Professor Thomas Koening of Northeastern University).

[123] Agency approval obtained through misrepresentation may not be invoked under the compliance defense provision. *See* S. 640, 102d Cong., 1st Sess. § 303(c) (1991).

[124] S. REP. No. 215, *supra* note 4, at 81.

[125] *Id.* at 83. The Copper 7 IUD is the only case mentioned by the minority members of the Committee as an example of manufacturer misbehavior resulting in the continued marketing of an improperly approved product. Professor Michael Rustad cites the example of the Surgidev Corporation's continued sale of a contact lens which it knew was three to five times more likely to cause sight-threatening injury than was common in such lenses. *See Hearings*, *supra* note 43, at 152.

[126] S. REP. No. 215, *supra* note 4, at 84.

and eliminate cases of "flagrant misconduct" or conduct "far in excess" of acceptable behavior. The only way an agency could overlook such conduct is if that conduct were misrepresented or concealed, in which case section 303(c) is inapplicable.

E. *Settlement and Alternative Dispute Resolution*

The settlement proposal in section 201 and the ADR proposal in section 202 appear to be moderate attempts to weed out suits before the expensive processes of discovery and trial commence.[127] Twenty-four states use ADR. Section 202 would impose the minority rule on all states.[128]

Section 202 may expedite settlement before discovery. Because discovery accounts for a large part of widely criticized litigation costs, encouraging settlement before discovery would substantially reduce those costs.

The ADR and settlement proposals raise concerns about the effect of using attorneys' fees as the means to encourage settlement and the extent to which the measure infringes on the right to a jury trial. Section 202 presumes that a party that refuses to engage in ADR is not acting in good faith. The presumption shifts attorneys' fees from the refusing party to the offeror when the trial verdict is adverse to the refusing party. The Act gives a judge no discretion to override this presumption or to consider the potential inequity of such an award.

This lack of discretion is problematic because in some instances paying attorneys' fees may constitute excessive punishment for merely refusing ADR. According to the supporters of S. 640, attorneys' fees account for a large percentage of the cost of litigation.[129] The financial burden placed on a party as a result of these fees may be excessive, even when the party is a corporation. When the party is an individual plaintiff, the threat of such an award may well deter her from insisting on her right to a jury trial.[130]

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[127] Under the existing system, 95% of product liability suits ultimately settle before or during trial. VISCUSI, *supra* note 50, at 6.

[128] For a useful outline of existing state ADR systems, see *Hearings*, *supra* note 43, at 220 (chart accompanying response of Professor Kelly to questioning by Sen. Kasten).

[129] 138 CONG. REC. S6434 (daily ed. May 12, 1992) (statement of Sen. Kasten).

[130] Section 201(f) provides that a deduction of defendant's attorneys' fees "shall not exceed that portion of the verdict which is allocable to noneconomic loss and economic loss for which the claimant has received or will receive collateral benefits." This proviso may mitigate the potential chill on the Seventh Amendment. Nevertheless, even with

A related concern is that imposing the threat of attorneys' fees for a refusal to settle early denies the plaintiff the opportunity to fully determine the extent of the defect or the seller's or manufacturer's negligent behavior. This may cause the plaintiff to settle without adequate information about the strength of her case. If discovery sometimes furthers the public purpose of uncovering threats to health and safety, negative incentives for pre-discovery settlement will undermine that goal.[131]

It may be difficult to predict whether sections 201 and 202 will deter plaintiffs from exercising their right to a jury trial. Nevertheless, as the Committee minority points out, where the effect of imposing a federal standard that preempts state law is uncertain, the burden ought to rest on the proponents of the measure to address and dispel these concerns.[132] After fifteen years of studying the product liability system, the proponents of ADR have not met this burden.

A possible change to sections 201 and 202 which might remedy the problems discussed above would be to give the judge discretion to award attorneys' fees, instead of requiring such an award.[133] With such discretion the judge might consider the financial situation of the parties, the seriousness with which either party has pursued the litigation, and the likelihood of either party succeeding at trial.

In addition, a discretionary rule would prevent awards of attorneys' fees from becoming punitive devices.[134] In cases in

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the protection afforded the plaintiff by § 201(f), the consequence of shifting attorneys' fees onto the plaintiff still may be to leave her largely or wholly uncompensated for her injury. Undoubtedly, this will deter many cases that may, in fact, be valid. Further, § 202 has no such proviso for the plaintiff who refuses an offer to enter ADR.

[131] *See* Arthur R. Miller, *Confidentiality, Protective Orders, and Public Access to the Courts*, 105 HARV. L. REV. 427, 477–82 (1991) (discussing the occasions in which there is a public interest in the discovery process). More significantly, plaintiffs, particularly those in toxic tort cases involving latent harms or injuries that develop over long periods of time, may never learn the full extent of their own injuries without discovery.

[132] S. REP. No. 215, *supra* note 4, at 68 (minority view of Sen. Hollings and Sen. Gore) ("[W]e only should tinker with the fundamental principles of federalism in the most extreme circumstances—a record such as we have on this issue is insufficient to take such action.").

[133] *Cf.* FED R. CIV. P. 54(d) (granting the district court judge jurisdiction to deny costs to the prevailing party); Farmer v. Arabian Am. Oil Co., 379 U.S. 227 (1964) (recognizing the discretion of judges to award costs for items not specifically addressed by statute).

[134] The justifications offered by Dan Quayle indicate that § 202 is intended to be a punitive measure. Describing his "loser pays" plan for civil litigation, he asserted that "[p]eople contemplating litigation may thing [sic] more carefully about it if they are confronted with the notion of paying the other side's legal fees in a losing suit . . . . Many would decide that it's better to settle and many would decide not to file at all." Quayle, *supra* note 1.

which an award of attorneys' fees would place a significant financial burden on the plaintiff and confer a negligible benefit on the defendant, the judge should be free to refuse to grant such an award. The proposed system is not without some discretion, but its presumption against the party who has refused to enter ADR proceedings unnecessarily restrains such discretion. It may have the effect of chilling plaintiffs who do not possess the financial resources to pay what one witness at an S. 640 hearing called "a small army of Philadelphia lawyers" hired by the defendant.[135] Proponents of S. 640 already bear the burden of demonstrating the need for and positive effect of S. 640 in light of federalism's deference to state sovereignty.[136] If this Act poses even the possibility that Seventh Amendment rights may be chilled, then the burden of justifying S. 640 is even greater.

The S. 640 proponents attempt to undermine the characterization of section 202 as an "anti-plaintiff provision" by describing it as an option available to either party with symmetrical risk of penalty.[137] In addition, they note that eighteen states as well as the federal district courts have a system of "financial incentives" for encouraging settlement before trial.[138]

Neither of these arguments is compelling. The concern over the proposed ADR procedure under S. 640 lies not in whether ADR is binding for the plaintiff or whether it bears some structural similarity to an existing "incentive" for settlement. Rather, the central concern is whether shifting potentially huge attorneys' fees to plaintiffs who are incapable of affording such a burden would have the practical effect of chilling Seventh Amendment rights.

Federal Rule of Civil Procedure 68 or similar state provisions are not useful. These rules require only the payment of "costs" incurred after a settlement offer has been made and rejected by the opposing party.[139] In this context, the term "costs" refers

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[135] *Hearings*, *supra* note 43, at 167 (testimony of J. Kendall Few, representative of the South Carolina Jury Trial Foundation).

[136] *See* TRIBE, *supra* note 95, § 5-21.

[137] The majority on the Committee preferred the more palatable term "incentive" to describe the awarding of attorneys' fees. S. REP. NO. 215, *supra* note 4, at 29.

[138] *Id.*

[139] FED. R. CIV. P. 68. One important parallel between Rule 68 and the proposed §§ 201 and 202 bears mention. The drafters of S. 640 incorporate into the proposed sections the Supreme Court's interpretation of Rule 68 as applicable only in those cases in which the party that has refused a settlement offer obtains a *favorable* judgment in an amount less favorable than the proposed offer. *See* Delta Air Lines v. August, 450

only to items such as court filing fees, printing fees, expert witness reimbursement, and deposition transcript costs.[140] Only under circumstances which are statutorily authorized does the term "costs" include attorneys' fees.[141]

Given hourly rates of defense attorneys, and the length and complexity of some product liability cases (made more complicated by the Act's eradication of joint and several liability for non-economic harm and strict liability for product sellers), a wholesale shifting of attorneys' fees under section 202 would significantly expand the penalty a plaintiff might incur for exercising her Seventh Amendment rights.

IV. Conclusion

The Product Liability Fairness Act represents the latest attempt by the congressional supporters of the business community to address what they perceive as a growing burden on national competitiveness. Efforts over the last decade to address the worsening crisis in product liability have failed at the federal level, and business interests and supporters of tort reform more appropriately have pursued their agendas on the state level.

Although some of the Act's provisions include desirable modifications of the existing product liability regime, it is an inappropriate measure to deal with a problem that is being solved currently in state legislatures and courts. The genesis of the reform effort at the federal level came at a time when the product liability system appeared, from the perspective of manufacturers, product sellers, and insurance carriers, to be failing. In the intervening decade, new trends have emerged which obviate the need for imposing inflexible federal standards on the states.

While the sense of a deepening crisis may once have justified the risk of diminished respect for state sovereignty, and of imposing unknown and adverse consequences on fair plaintiff re-

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U.S. 346 (1981). Neither the Rule nor §§ 201 or 202 apply when the party that has refused settlement or ADR loses its case at trial.

[140] 28 U.S.C. § 1920 (1988).

[141] *See* Marek v. Chesny, 473 U.S. 1 (1985) (holding that "costs" includes attorneys' fees in an action under 42 U.S.C. § 1988 because that statute specifically allows awarding attorneys' fees).

coveries, the current absence of a crisis undermines this justification. Congress should not supplant a traditional area of state concern when states are adopting reforms to improve the system.

—Robert A. Goodman

BOOK REVIEW

POLITICAL QUESTIONS/JUDICIAL ANSWERS: DOES THE RULE OF LAW APPLY TO FOREIGN AFFAIRS? By *Thomas M. Franck.* Princeton, N.J.: Princeton University Press, 1992. Pp. 198, notes, index. $24.95 cloth.

It is hard to miss the irony of it all, and Thomas M. Franck[1] does not. From the very decision establishing the judiciary as the ultimate arbiter of statutory and constitutional meaning was born a doctrine making the political branches the masters of their own constitutional fate. Spawned by the dictum of *Marbury v. Madison*,[2] the political-question doctrine[3] exempts from judicial scrutiny much of the political branches' conduct of foreign affairs.[4] In *Political Questions/Judicial Answers: Does the Rule of Law Apply to Foreign Affairs*, Franck argues that this constitutionally misguided doctrine should be abandoned and foreign affairs placed within the reach of judicial review.

Franck deplores what he regards as the "abdication" of judicial responsibility that results from invocation of the political-question doctrine (p. 4). Yet he recognizes that political-question jurisprudence is not marked by wholesale abdication. Rather, the state of the law is confused and incoherent. Procedural decisions and decisions on the merits in foreign affairs cases are as numerous as abdications. "Barring the way to reform is not a firm if pernicious principle of abdication but a state of jurisprudential chaos" (p. 8). Thus, Franck's mission is twofold. Not only does he argue for the elimination of abdication, but also for an orderly legal approach to end the chaos.

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[1] Thomas Franck is Murry and Ida Becker Professor of Law and Director of the Center for International Studies at the School of Law, New York University.

[2] 5 U.S. (1 Cranch) 137, 176–78 (1803). "By the constitution of the United States, the President is invested with certain important political powers, in the exercise of which he is to use his own discretion, and is accountable only to his country in his political character and to his own conscience . . . . The acts of such an officer, as an officer, can never be examinable by the courts." *Id.* at 165–66.

[3] The political-question doctrine holds that certain issues, because of their purely political character or because their determination would involve encroachment upon the powers of the Executive or Legislative Branches, should not be decided by the courts. BLACK'S LAW DICTIONARY 1158 (6th ed. 1990).

[4] The political-question doctrine has also been applied to domestic affairs, though Franck notes that its domestic use has been "virtually eradicated in recent years" (p. 19). The book would benefit from a more substantial discussion of the doctrine's domestic application and the relationship between the doctrine's domestic and foreign affairs components.

So how did the theory arise that foreign affairs are "*different* from all other matters of state in some crucial fashion" (p. 3) and not susceptible to judicial review? Franck's analysis of the history is revealing. He points out that the early Supreme Court's reliance on British precedent in foreign relations cases imported into U.S. jurisprudence a "monarchial notion of indivisible power over foreign affairs" (p. 12). Franck correctly characterizes this notion as contrary to the American constitutional system of divided and limited government and plainly incompatible with the Constitution's grant of foreign affairs powers to both the Executive and the Legislative Branches. He believes he understands why the courts nonetheless adopted this conception of undivided and unreviewable foreign relations authority. The courts entered into a "Faustian pact" (p. 12) with the political branches. Struggling in the early days of the Republic to establish its legitimacy, the federal judiciary ceded reviewing authority over foreign relations in order to gain the political branches' acquiescence to its assertion of authority over domestic affairs.

Various rationales appealing to citizen and judge alike have supplemented these early considerations and help to explain the continuing acceptance of the notion that the political branches must act with unfettered discretion in the field of foreign relations. Franck describes the view of many that the world of international relations is a jungle in which concentrated power is necessary in order for the United States to effectively protect its interests. Supporters of the political-question doctrine point out that few other nations must endure judicial restrictions on foreign policy power, so American courts should not impose this "handicap" on the U.S. government (p. 14). Similarly, the government must speak with a single voice so as not to appear indecisive and weak in the eyes of foreign nations. The Supreme Court forcefully endorsed this line of reasoning in *United States v. Curtiss-Wright Export Corp.*[5] Franck notes with irony that, as in *Marbury*, the Court's sweeping calls for deference in foreign affairs are mere dicta. Nevertheless, as with *Marbury*, the deferential language of *Curtiss-Wright* has fueled the tradition

[5] 299 U.S. 304 (1936) (holding that the doctrine that the federal government can exercise only powers specifically enumerated in the Constitution or powers implied from enumerated powers is categorically true only in internal affairs).

of political-question abdication, particularly among the lower courts.

In identifying the legal rationales underlying the political-question doctrine, Franck echoes Professor Alexander Bickel.[6] One rationale focuses on constitutionally mandated limits on judicial action, while the other focuses on self-imposed prudential limits. A difference of opinion on the relevant constitutional limits is a significant factor in the jurisprudential chaos. To most judges and scholars, the Constitution's limit on judicial action merely requires that if, in the Court's opinion, a political branch has acted "within its constitutionally allotted ambit of political discretion, the Court will not replace the political judgment of a coordinate branch with its own preferences" (p. 31). But some have read the Constitution to place much greater limits on judicial action: "If in the opinion of one of the political branches that branch is authorized by the Constitution to take an action, the Court will not substitute its view of whether such action is constitutionally authorized for that of the political branch" (p. 31). It is this latter, expansive view that produces the wholesale abdication Franck deplores. He endorses the former narrow view because it allows for judicial review of the constitutional limits on executive and legislative foreign affairs power.[7] Franck's analysis of this debate over constitutional limits would benefit from a discussion of the text of the Constitution, particularly since neither the text nor the *Marbury* decision compels the conclusion that the judiciary's interpretation of the Constitution is definitive.[8]

Were the expansive constitutional rationale the only justification for the political-question doctrine, Franck asserts that it "could be dismissed as a historic device of dubious origins, perhaps necessitated at an early stage of judicial ascendance, built on ill-considered dicta and kept alive with mirrors" (p. 45). Yet the courts have also articulated forceful prudential reasons for limiting judicial action and they increasingly employ these reasons as the sole basis for abdication in foreign affairs cases. Courts have identified four primary prudential concerns:

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[6] ALEXANDER BICKEL, THE LEAST DANGEROUS BRANCH 184 (1962) (identifying two conceptual components of abdicationism: constitutionally mandated limits and self-imposed prudential limits).

[7] Both views of the Constitution wisely prevent courts from second-guessing policy judgments made by the political branches.

[8] Professor Kathleen Sullivan, Lecture at Harvard Law School (Sept. 10, 1992).

(1) foreign affairs cases often turn on factual evidence which courts are not able to obtain or are not suited to assess; (2) such cases present policy questions for which legal standards are unascertainable or inapplicable; (3) when the resolution of the issues is critical to the well-being of the nation, decisions should be made by foreign policy experts; and (4) a decision inconvenient for the political branches might be ignored, producing an unwinnable confrontation for the judiciary. Any attempt to repudiate the political-question doctrine must address these prudential concerns in order to convince courts that it is safe to venture into the realm of foreign relations.

Franck's main response to the four prudential concerns listed above is that they are misguided or outdated. He believes that formulating rules of evidence in order to properly assess facts, and ascertaining legal standards from previously murky areas of the law are uniquely judicial activities that courts should exercise in the foreign affairs arena as they do in others. He also argues that modern technology has made facts from around the globe easily obtainable, and that the vulnerability of the judiciary in clashes with other governmental branches is largely a thing of the past. While he does reveal weaknesses in each prudential rationale, Franck is too quick to discount the valid bases underlying each limit. The reader is left unconvinced by Franck's apparent belief that the prudential concerns expressed by the courts are not serious.

Franck proposes specific mechanisms to address what he regards as the two most valid anxieties about the adjudication of foreign affairs cases: the government's legitimate need to protect secret information, and its need to be able to use force quickly and decisively. He proposes mechanisms by which courts could protect these legitimate interests while still assuming jurisdiction over cases in which they are implicated. To deal with the question of secrecy, he proposes greater reliance on in camera proceedings for review of sensitive information. Both Congress and the courts have directed that these procedures be utilized in other areas of the law,[9] and Franck demonstrates that such procedures have proven successful in balancing the need for secrecy with the demand for disclosure. Franck convincingly

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[9] *See* Freedom of Information Act §§ 1801–1804, 5 U.S.C. § 552 (1986); Classified Information Procedures Act, 18 U.S.C. app. §§ 1–16 (1988); Foreign Intelligence Surveillance Act § 301, 50 U.S.C. §§ 1801–1811 (1988).

argues that in camera proceedings would effectively protect the secrecy interests of the U.S. government and that the benefits from their use outweigh the additional administrative burdens.

Franck's proposal for cases involving the use of force reveals him to be more pragmatic than one would think from reading his earlier categorical statements about subjecting foreign policy to the rule of law. He maintains that "[the courts] must have at hand a remedy with less stark consequences than an order to desist or compel action" (p. 153). He proposes the remedy of a declaratory judgment (rather than an injunction) in cases where military engagements may already be under way. Franck's circumspect approach to situations in which American troops are deployed in a potentially unconstitutional engagement is certainly wise, but it is nonetheless surprising in light of his declared search for bright-line principles. And his recommended remedy does not necessarily resolve the practical difficulties he associates with injunctions. The legitimacy of the judiciary would suffer greatly should declaratory judgments of unconstitutionality go unheeded by the political branches, a not unlikely possibility. Such judgments would no doubt buttress and legitimate opposition to the particular use of force, but the costs in terms of the court's own legitimacy and interbranch conflict might outweigh this benefit. Consideration of such concerns and a generally more thorough explanation would improve Franck's discussion of the declaratory judgment proposal. For example, he mentions the "deliberate-speed" order of the *Brown v. Board of Education (Brown II)* school desegregation case,[10] but does not make clear whether he recommends using such orders in the use of force/foreign affairs context.

In analyzing the confused state of American political-question jurisprudence, Franck identifies several root causes of the disorder. Much of the confusion results from what he calls "double-entry bookkeeping" (p. 21), by which courts invoke the political-question doctrine, but then, despite protestations about lacking authority to decide the case, nonetheless proceed to a decision on the merits. The Supreme Court itself has engaged in this disingenuous practice on numerous occasions.[11] Franck de-

[10] 349 U.S. 294 (1955).

[11] *See* Clark v. Allen, 331 U.S. 503 (1947); Terlinden v. Ames, 184 U.S. 270 (1902); The Prize Cases, 67 U.S. (2 Black) 635 (1862). It is interesting to note, as Franck does, that "when the Court does deal with the merits of a case . . . it has generally found in favor of the challenged exercise of executive and/or legislative power" (p. 21). In cases

scribes how "the abstentionist language in these [cases] has been seized upon by lower-court judges to reinforce their own abdicationist tendencies rather than being recognized as no more than peripheral rhetoric" (p. 21). Thus, not only are the Supreme Court's own cases confused, but they result in the lower courts being out of step on the question of whether to reach the merits of political-question cases. Additional confusion results from the Supreme Court's failure even to mention the political-question doctrine in cases that clearly implicate it.[12] Furthermore, Franck shows that courts have been more willing to assert jurisdiction when a foreign affairs case implicates property rights[13] or basic personal liberties.[14] It is easy to see why judges are at a loss as to how to proceed in this area of the law.

As part of his search for solutions to the chaos, Franck discusses how the courts of the Federal Republic of Germany have grappled with the issue of judicial review of foreign affairs. Franck sees the German legal system as having achieved the twin goals he has set for the United States: a methodical approach to foreign affairs cases and an avoidance of abdication. He finds the German constitutional regime a particularly suitable analogue since it depends on a system of governmental checks and balances and because the German Basic Law, like the U.S. Constitution, "neither requires nor precludes judicial reticence in foreign relations" (p. 107).[15] Franck's analysis of German jurisprudence demonstrates that, when it comes to actual results, the German courts tend to be just as deferential to the political branches as U.S. courts. It is in judicial posture and judicial language that the German courts differ. German courts

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where the evidence allows, therefore, the Court boosts its own legitimacy by moving beyond declarations of abdication and deference to engage in the judicial exercise of weighing the evidence before it. While some might argue that the Court's reaching of the merits undermines the authority of the political branch in question, the conduct of the political branch may in fact be legitimated by the imprimatur of impartial judicial determination.

[12] *See* Dames & Moore v. Regan, 453 U.S. 654 (1981); Youngstown Sheet & Tube Co. v. Sawyer (The Steel Seizure Case), 343 U.S. 579 (1952).

[13] *See Youngstown Sheet & Tube*, 343 U.S. 579; Mitchell v. Harmony, 54 U.S. (13 How.) 115 (1851).

[14] *See* New York Times Co. v. United States, 403 U.S. 713 (1971); Zweibon v. Mitchell, 516 F.2d 594 (D.C. Cir. 1975).

[15] Despite these similarities, Franck acknowledges that the German courts "took quite a different and less complex responsibility than would American courts if they were similarly to extend the scope of judicial review" (p. 137). The responsibility of the German courts is distinct because Germany's foreign policy does not have the same "special global role" as does that of the United States (p. 137).

start from the premise that all cases, including those implicating foreign affairs, are justiciable. There is no talk of abdicating or exempting the political branch from constitutional scrutiny. When the courts reach the merits, however, they are remarkably deferential to the political branches, applying a very narrow standard of review.

It is disappointing to see Franck trumpet the German approach as a great success. It is not that he is unaware of the disingenuousness and toothlessness of the German jurisprudence. He admits that "[i]n its theoretical pronouncements, neither [the American nor the German] judiciary is entirely candid about what it is doing. The German judges sound more assertive . . . than they really are" (p. 124). Yet he applauds the cosmetic changes in judicial posture and rhetoric as a significant improvement over the U.S. approach. Franck believes such seemingly minor changes can positively affect "the legal culture of a society manifesting that in government none is omnipotent" (p. 125). Perhaps his celebration of the German approach also reveals Franck's frustration with U.S. jurisprudence and his belief that improvements beyond changes in posture and rhetoric are not currently possible. He says the German approach ensures that litigants with claims against the government will have their day in court, unlike in the United States. True, but Franck's own analysis demonstrates that these litigants will lose. The deferral of defeat from the jurisdictional phase (as in the United States) to the merits phase (as in Germany) may do little to assuage citizens convinced that their government has exceeded the law. Unable to point to a difference in outcomes between the American and German approaches, Franck also heralds order for order's sake. "Nevertheless, the German Constitutional Court has at least managed to develop a seamless theory and by and large has given it a consistent application" (p. 124). Given Franck's outrage at the American political branches' escape from meaningful judicial scrutiny, his fondness for a German system that seems to provide only marginally more review is surprising.

Franck argues that the curtailment of other American abdicationist doctrines provides additional guidance for resolving the political-question confusion in the United States. Congress has curtailed abdication by requiring the courts to decide two types of foreign affairs cases in which the courts had tradition-

ally deferred to the political branches. The Hickenlooper Amendment of 1964[16] prohibited the courts from employing the "act of state" doctrine to avoid deciding cases in which property had been seized by a foreign state. Similarly, the Foreign Sovereign Immunity Act of 1976[17] made the courts the arbiter of sovereign immunity standards, reversing the courts' practice of ceding to the political branches' interpretation. Franck argues that the political branches' support for these legislative acts demonstrates that policy-makers do not necessarily believe that abdication is in the national interest. He notes that the exercise of jurisdiction has not had detrimental consequences for U.S. foreign relations. In addition, the courts' willingness to decide these foreign affairs cases proves that the judiciary does not, in fact, believe that the Constitution mandates abdication. Franck believes that the act of state and sovereign immunity experiences undercut much of the rationale for the political-question doctrine and recommend greater judicial involvement in all varieties of foreign affairs cases. He fails to recognize, however, that a determination by the political branches that the courts should decide a given type of foreign relations case is quite different from the judiciary making this determination itself. The very fact that the political branches have conferred jurisdiction addresses many of the prudential concerns outlined above. Passage by Congress and signature by the President indicate that the political branches have determined that a given type of dispute is not critical to international relations, does not require their foreign relations expertise, and is amenable to judicial resolution. And certainly the fact that the political branches have affirmatively conferred jurisdiction reduces the chances of the political branches ignoring an unfavorable judicial decision. These prudential concerns remain unaddressed, however, when it is the courts themselves that decide to hear foreign affairs disputes.

Franck points out that the Supreme Court has not attempted a comprehensive review of the political- question doctrine since *Baker v. Carr*[18] and has lately shirked responsibility by refusing

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[16] Foreign Assistance Act of 1964 § 301(d)(2), 22 U.S.C. § 2370(e)(2) (1988).

[17] Foreign Sovereign Immunity Act of 1976, 28 U.S.C. §§ 1330, 1332(a)(2)–(4), 1391(f), 1441(d), 1602–11 (1988).

[18] 369 U.S. 186 (1962) (holding that complaint alleging that a state statute effected an apportionment that deprived plaintiffs of equal protection presented a justiciable constitutional cause of action rather than a nonjusticiable political question).

to grant certiorari in foreign affairs and national security cases. He concludes his book by calling upon the Supreme Court and/or Congress to assume responsibility and offer a "comprehensive new theoretical pronouncement" on political-question jurisprudence (p. 136).

In *Political Questions/Judicial Answers*, Franck comprehensively and skillfully treats the political- question doctrine's place in the history of American jurisprudence. He identifies the premises, some valid, some not, on which this doctrine so seemingly out of step with the rest of American law is based. He successfully demonstrates the urgent need for clarification of political-question jurisprudence, at the very least so that courts will approach foreign affairs cases in the same way. He is somewhat less successful in articulating a rationale for ending political-question abdication altogether. He does unearth the doctrine's suspect origins in British precedent and Supreme Court dicta. And although he might have given greater attention to the text of the Constitution and to the Framers' intent, Franck convinces the reader that the narrow interpretation of the Constitution's limits on judicial action is the superior one. He is at his weakest in responding to the prudential underpinnings of the doctrine. His proposal regarding in camera proceedings is wise and practicable, but he fails to persuade the reader that the judicial anxieties about deciding foreign affairs cases are insubstantial. Franck ultimately recommends highly deferential standards of review and rules of evidence as the preferred substitutes for outright abdication. These recommendations would increase judicial review of the conduct of foreign affairs by the political branches, but they seem quite conservative considering that Franck describes the political-question doctrine as "wholly incompatible with American constitutional theory" (pp. 4–5). One is left to wonder whether Franck refrains from proposing more probing review because he believes that courts would not implement it, or perhaps because he finds the prudential grounds for restraint more compelling than he acknowledges.

—James M. Delaplane, Jr.

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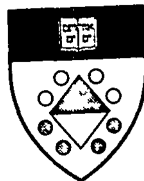

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